

IN THE UNITED STATES DISTRICT COURT FOR THE  
EASTERN DISTRICT OF CALIFORNIA

8 FLAGSHIP WEST, LLC, et al., )	No. CV-F-02-5200 OWW/DLB
9 )	MEMORANDUM DECISION AND
10 Plaintiffs, ) ORDER GRANTING PLAINTIFFS'	
11 vs. ) MOTION FOR INTERPRETATION OF	
12 EXCEL REALTY PARTNERS, L.P., ) LEASE (Doc. 500) AND DENYING	
13 et al., ) DEFENDANT'S MOTION TO STRIKE	
14 ) AND/OR FOR LEAVE TO FILE	
15 Defendants. ) SUR-REPLY BRIEF (Doc. 508)	
16 _____)	

This case is before the Court after remand by the Ninth Circuit Court of Appeal. The Ninth Circuit reversed the Court's granting of Flagship West, LLC's and Marvin and Kathleen Reiche's ("Flagship") election of rescission of its lease with Excel Realty Partners, L.P. ("Excel") after a jury found that Excel materially violated an "exclusive use" provision of the lease. The trial court ruling that judicial estoppel precluded Excel from asserting that § 4.5 of the lease bars rescission, was not

1 warranted and the limited remand was "so that the district court  
2 may determine in the first instance whether the contract, in its  
3 entirety, allows for rescission and whether California law would  
4 give effect to the lease's limitations on remedies in these  
5 circumstances." Specifically:

6 Excel ... appeals the district court's order  
7 granting Excel's tenant ..., rescission of  
its lease based on a determination that Excel  
materially violated an 'exclusive use'  
provision of that lease. The district court  
invoked judicial estoppel to prevent Excel  
from asserting that § 4.5 of the lease bars  
rescission. Because we find judicial  
estoppel was not warranted here, we remand  
for the district court to determine whether  
rescission is an available remedy under  
California law and the terms of the contract.

12 ...  
13

First, Excel's litigation positions were not  
clearly inconsistent. There is no evidence  
that Excel ever conceded that rescission was  
available to Flagship. Although the Pretrial  
Order did not specifically cite § 4.5 of the  
lease or discuss all of the arguments that  
might be based on the section, it  
acknowledged that Excel contested Plaintiffs'  
entitlement to rescind, at least on both  
materiality and independent covenant grounds.  
Other related arguments that rescission was  
not available, including the contractual  
limitation on remedies argument at issue,  
were adequately embraced within the order

21 ....  
22

Second, the district court never relied on a  
party's inconsistent statements ... Even  
though the district court may have been under  
the impression that rescission was being  
'actively litigated,' judicial estoppel is  
not appropriate unless the court made rulings  
in reliance on an admission by Excel that  
rescission was in fact available. No such  
reliance is possible here because, throughout  
the proceedings, Excel actively contested the

1 availability of rescission on a theory-by-  
2 theory basis. Excel had no legal obligation  
3 to pursue a general legal argument against  
4 rescission prior to its more narrow arguments  
because the argument regarding limitation of  
remedies available under the contract is not  
an affirmative defense under Fed. R. Civ. P.  
8(c) ....

5 Third, allowing Excel to raise its  
6 contractual remedies limitation argument  
7 after the jury had deliberated did not give  
Excel an unfair advantage or impose an unfair  
detriment on Flagship. Even if Excel had  
8 raised the argument at an earlier stage, the  
same factual issues would have been put to  
9 the jury to determine liability for damages.

10 Consequently, we vacate the district court's  
judgment awarding rescission damages to  
Flagship and remand so that the district  
court may determine in the first instance  
whether the contract, in its entirety, allows  
for rescission and whether California law  
would give effect to the lease's limitations  
on remedies in these circumstances. We do  
not reach either party's claims related to  
the calculation of rescission damages and  
express no opinion on those claims.

16 A supplemental scheduling conference was held. The  
17 Supplemental Scheduling Conference Order filed on August 14, 2009  
(Doc. 499), states: "Plaintiff shall not raise any new matter in  
18 the reply memorandum of law."

20 Flagship seeks interpretation of § 4.5 of the lease as not  
21 precluding rescission of the lease. Excel opposes Flagship's  
22 motion.

23 A. BACKGROUND.

24 Excel is the owner of the Briggsmore Plaza in Modesto. On  
25 July 16, 1998, Excel executed a 15 year ground lease ("Lease")  
26 with Flagship, whose only members are the Reiches, for a stand-

1 alone 10,000 square foot lot (the "Property") in the Briggsmore  
2 Plaza for the purpose of constructing and operating a buffet  
3 style restaurant under the Golden Corral franchise (the  
4 "Restaurant"). The Lease provides that Flagship has the  
5 "exclusive right to operate a self service buffet style family  
6 restaurant within the Shopping Center." (Lease § 6.3).

7 To construct the Restaurant, Flagship borrowed a 25 year, \$2  
8 million loan from The Money Store, which was secured by a deed of  
9 trust on Flagship's leasehold interest in the Property. The  
10 Reiches also executed written personal guarantees of the loan.  
11 The Restaurant opened on June 10, 1999, Approximately a year  
12 later, the Four Seasons, a buffet restaurant serving Chinese  
13 food, opened in the Briggsmore Plaza in a location directly  
14 across from the Restaurant. Based on an express lease provision,  
15 Flagship contended that the operation of the Four Seasons  
16 breached their exclusive right to run a buffet style restaurant  
17 in the shopping center and caused the Restaurant to become  
18 unprofitable, leading to its closure on April 1, 2001.

19 Flagship filed suit against Excel, alleging breach of  
20 contract, fraud, and negligent misrepresentation, seeking  
21 contract damages and rescission. In the Pretrial Order, Flagship  
22 requested a jury trial on all issues, while Excel relied on  
23 Flagship's jury demand instead of making one themselves. The  
24 case was tried to a jury. The trial commenced on November 12,  
25 2003 and verdicts were returned on December 3, 2003. The  
26 general verdict with interrogatories found in favor of Flagship

1 and awarded Flagship \$1,502,000.00 in contract damages.  
2 Specifically, the jury found that Flagship proved "by a  
3 preponderance of the evidence, that Defendant Excel Realty  
4 Partners, L.P., breached the lease by leasing space in the  
5 Briggsmore Plaza to Bi Wen Liu for the operation of the Four  
6 Seasons Buffet" and Excel's "breach of paragraph 6.3 of the lease  
7 agreement [was] material." (Doc. 280). Entry of judgment was  
8 deferred to allow Flagship to elect the remedy of rescission and  
9 any rescission damages or damages for breach of contract.

10 The "Order Re: Post Trial Election of Remedies; Defendants'  
11 Claimed Rescission Waiver Clause; Defendants' Claimed Damage  
12 Limitation Clause" filed on November 19, 2004 (November 19, 2004  
13 Memorandum Decision; Doc. 353), notes the parties' extensive  
14 post-trial briefing, addressing a number of issues. Rescission  
15 was elected and rescission damages awarded. A remedies lease  
16 provision barring rescission was found unenforceable.

17       B. FLAGSHIP'S MOTION FOR INTERPRETATION OF LEASE.

18       The primary issue before the Court is the proper  
19 interpretation of § 4.5 of the lease.<sup>1</sup> Section 4.5 provides:

20       4.5 Triple Net Lease. Tenant's Basic Rent  
21 and Additional Rent shall be absolutely net  
22 to Landlord, so that this Lease shall yield  
23 to Landlord the full amount of the  
installments of Basic Rent and Additional  
Rent throughout the Term, and shall be paid  
without assertion of any counterclaim, set

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24  
25       <sup>1</sup>At the hearing, Excel asserted that the Ninth Circuit's  
Memorandum remanding this case ruled that Section 4.5 constitutes  
a limitation on Flagship's right to rescind the lease. No such  
ruling can be inferred from the Ninth Circuit's Memorandum.

1 off, deduction or defense and without  
2 abatement, suspension, deferment, diminution,  
3 reduction or refund of any kind, except as  
4 expressly set forth herein. Under no  
5 circumstances whether now existing or  
6 hereafter arising, or whether beyond the  
7 present contemplation of the parties, shall  
8 Landlord be required to make any payment or  
9 refund of any kind whatsoever or be under any  
10 obligation or liability hereunder, except as  
11 expressly set forth herein. Except as  
12 otherwise expressly set forth in this Lease,  
13 this Lease shall continue in full force and  
14 effect, and the obligations of Tenant  
15 hereunder shall not be released, discharged  
16 or otherwise affected, by reason of any of  
17 the following: (a) any damage to or  
18 destruction of the Premises or any portion of  
19 either or any Taking of the Premises or any  
portion of either; (b) any restriction or  
prevention of or interference with any use of  
the Premises or any portion of either; or (c)  
any other occurrence whatsoever, whether  
similar or dissimilar to the foregoing, in  
each case, whether or not Tenant shall have  
notice or knowledge of any of the foregoing.  
The obligations of Tenant in this Lease shall  
be separate and independent covenants and  
agreements. Tenant hereby waives, to the  
fullest extent permitted by the applicable  
law, any and all rights now or hereafter  
conferred by statute or otherwise to quit,  
terminate or surrender this Lease or the  
Premises or any portion thereof, or to any  
abatement, suspension, deferment, diminution,  
reduction or refund of Basic Rent or  
Additional Rent, except as otherwise  
expressly set forth herein.

20       1. Independent and Separate Covenants.

21       Excel argues that rescission is barred because Flagship's  
22 obligations under the Lease are explicitly made separate and  
23 independent covenants by Section 4.5. Excel refers to the "Order  
24 Re: Post Trial Election of Remedies; Defendants' Claimed  
25 Rescission Waiver Clause; Defendants' Claimed Damages Limitation  
26

1 Clause," filed on November 19, 2004, (November 19, 2004  
2 Memorandum Decision, Doc. 353), and specifically to 49:2-3 and  
3 51:8-15:

4 Plaintiffs were experienced and sophisticated  
5 restaurant operators.  
6 ...  
7  
8 With respect to § 4.5, the Lease shows that  
9 the parties modified the provision, striking  
10 out the term 'or the Access Area' several  
11 times. These changes were ratified by  
12 initials 'MGR' (Marvin G. Reiche) in the  
13 margins. See Doc. 302, Ex. A, Lease, at 4.  
14 Plaintiffs cannot claim that § 4.5 escaped  
15 their notice.

16 Excel relies on these statements to assert that Section 4.5 was  
17 bargained for between sophisticated parties at arm's length.  
18 Therefore, Excel contends, Flagship cannot rescind or otherwise  
19 avoid their obligations under the Lease based on a violation of  
20 the exclusive use provisions in Section 6.3 of the Lease and  
21 asserts that Flagship's sole remedy is damages for Excel's breach  
22 of the exclusive use provisions.

23 Excel argues that it is unaware of any court that has  
24 allowed rescission for breach of an exclusive use clause in a  
25 lease that also provides that such clause is an independent  
26 covenant. Excel refers to the "Memorandum Decision and Order Re  
Post-Trial Election of Remedies" filed on September 30, 2005  
(September 30, 2005 Memorandum Decision, Doc. 362), at 14:13-17:

Breach of an independent covenant does not  
warrant rescission because, by definition,  
breach of an independent covenant is not  
material. By its very nature, an independent  
covenant does not run to the whole of the

1 consideration.

2 However, Excel's reference to the September 30, 2005

3 Memorandum Decision is incomplete:

4 Defendant asserts that materiality is not the  
5 central inquiry, and rather, the key inquiry  
6 is whether the covenant breached is  
7 independent. It is true that some courts  
8 approach the question of rescission based at  
9 least in part on an analysis of whether the  
10 provision breached was a dependent or  
11 independent covenant. See, e.g., *Medico-*  
*Dental*, 21 Cal.2d at 418-19; *Mills*, 56  
Cal.App. at 776. This follows because the  
factors that determine whether a covenant is  
independent, overlap with the factors that in  
determine [sic] whether a breach was  
material. *Medico-Dental*, 21 Cal.2d at 433.  
Breach of an independent covenant does not  
warrant rescission because, by definition,  
breach of an independent covenant is not  
material. By its very nature, an independent  
covenant does not run to the whole of the  
consideration. However, what Defendant has  
not provided is citation to any authority  
holding that exclusive use provisions, such  
as the one at issue here, are independent  
covenants as a matter of law. In fact, the  
courts in the two cases upon which Defendant  
relies, *Kulawitz* and *Medico-Dental*, found  
that the exclusive use covenants at issue  
there were dependent, based on an analysis of  
the factors and the factual record.

19 In this case, the jury has already made a  
20 finding that the breach was material. It is  
21 not necessary for the court to now decide, as  
22 a matter of law, that the covenant at issue  
23 was independent. The provision was integral  
24 to the Lease, which would not have been  
25 entered into without it. The answer to the  
mixed question of law and fact as to  
independence of the provision is irrelevant  
to the question whether the Plaintiff is  
entitled to elect rescission. The jury's  
finding of materiality provides sufficient  
grounds for rescission, according to well-  
established California law.

1 (September 30, 2005 Memorandum Decision at 14:4-15:5).

2       Excel argues that *Kulawitz v. The Pacific Woodenware and*  
3 *Paper Co.*, 25 Cal.2d 664 (1944) and *Medico-Dental Bldg. Co. v.*  
4 *Converse*, 21 Cal.2d 411 (1942), "stand for a proposition that has  
5 no bearing on this case." Excel contends that "[a]bsent an  
6 express statement in the lease that covenants are independent, a  
7 court may determine that the covenants involved are conditions  
8 precedent so that a breach may justify rescission if it goes to  
9 the heart of the matter." Excel contends that such analysis is  
10 only necessary where there is no explicit agreement by the  
11 parties and is unwarranted here "because the Ground Lease  
12 specifies that Plaintiffs' obligations are independent of Excel's  
13 compliance with its obligations." Excel asserts that the jury  
14 verdict of "material breach" during the breach of contract phase  
15 of the trial "does not overrule the clear tenant of California  
16 law that where the parties to a contract agree that the terms  
17 thereof are independent covenants, a breach will not justify  
18 rescission."

19       Excel's contention that Section 4.5 makes Excel's obligation  
20 to honor the exclusive use provisions of the Lease an independent  
21 covenant ignores the express wording of Section 4.5: Section 4.5  
22 deals with a tenant's obligation to pay rent and provides that  
23 "[t]he obligations of Tenant in this Lease shall be separate and  
24 independent covenants and agreements." Section 4.5 does not  
25 provide that any of the landlord's obligations under the Lease  
26 are independent covenants. As Flagship asserts: "Defendants cite

1 no authority in support of their position, and without  
2 explanation assert that because the Lease states Tenant's  
3 obligations are 'independent covenants,' that the Landlord's  
4 obligations are independent as well." Flagship cites *Medico-*  
5 *Dental*, *supra*, 21 Cal.2d at 419, in turn citing 32 Am.Jur. § 144,  
6 that "'covenants and stipulations on the part of the lessor and  
7 lessee are to be construed to be dependent upon each other or  
8 independent of each other, according to the intention of the  
9 parties and the good sense of the case, and technical words  
10 should give way to such intention.'" Flagship contends:

11 Excel's interpretation patently ignores the  
12 circumstances of this case, the undisputed  
13 evidence that the exclusive use provision was  
14 central to the Lease, and the jury's finding  
15 of materiality, in arguing that a clause  
16 providing that the Tenant's obligations are  
17 independent also means the Landlord's  
18 obligations are independent. In making this  
19 argument, Defendants are asking the court to  
20 read the word 'Landlord' into the provision,  
21 without any supporting evidence that that is  
22 what was intended by the parties.

23 Contrary to Excel's contention, Flagship argues, there is no  
24 "express statement" in the Lease making Excel's obligation to  
25 honor the exclusive use clause an independent covenant. Flagship  
26 argues that Excel's interpretation of Section 4.5 allows Excel to  
treat every obligation it had under the Lease as optional,  
precluding Flagship from rescinding the Lease under any  
circumstances:

Excel presents no support for its position  
that any party can be required to stay in a  
contract which the other party has materially  
failed to perform. Without the consideration

1           Flagship expressly bargained for, the Lease  
2           failed. The language making Flagship's  
3           covenants to pay rent 'independent' did not  
4           in any way [sic] alter Defendants' obligation to  
          honor the exclusive use provision, and does  
          not make that provision any less central to  
          the parties' bargain.

5           Excel argues that Section 6.3 of the Lease provides a remedy  
6           in damages for breach of the exclusive use clause. Section 6.3  
7           provides:

8           **6.3 Exclusive Use Rights.** Subject to the  
9           conditions and restrictions set forth herein,  
10          Tenant shall have the exclusive right to  
          operate a self service buffet style  
          restaurant within the Shopping Center, except  
          that such exclusive right:

11           ...

12           (h) Shall not result in Landlord being liable  
13          to Tenant for monetary damages for any other  
14          tenants' or occupants' violation of such  
          exclusive use privilege of Tenant unless,  
15          with respect to future tenants or occupants  
          ..., Landlord has failed to restrict such  
          tenant or occupant from violating Tenant's  
          exclusive use privilege granted in this Lease  
          ....

17           Flagship responds that Section 6.3(h) does not restrict the  
18          tenant from rescinding the Lease if Excel failed to prevent  
19          future tenants from violating Flagship's exclusive use privilege.  
20          Flagship notes that Excel cites no authority that a damages  
21          provision limits the ability of a party to a contract from  
22          rescinding the contract because of a material breach. Flagship  
23          cites California Civil Code § 1692, which provides that "[a]  
24          claim for damages is not inconsistent with a claim for relief  
25          based upon rescission." Flagship refers to the November 19, 2004  
26

1 Memorandum Decision that "[i]n the event rescission is elected, §  
2 22.25 cannot be enforced as rescission avoids enforceability of  
3 clauses of the Lease, including damage limitations."

4 Flagship's contentions are well-taken. Section 4.5 by its  
5 terms provides that the tenant's obligation to pay rent under the  
6 lease is an independent covenant. Section 4.5 does not refer in  
7 any way to the landlord's obligations to the tenant under the  
8 lease. To the contrary, Section 6.3 imposes an express duty on  
9 Excel to restrict any other tenant from violating Flagship's  
10 exclusive use privilege. This imposed an express obligation on  
11 Excel which was integral to the lease and represented a dependent  
12 covenant. The jury specifically found that Excel's breach of the  
13 exclusive use provision in Section 6.3 of the lease was material.  
14 Excel's contention that the jury's verdict on this issue is  
15 irrelevant to the determination that Section 4.5 makes Excel's  
16 obligations under the lease independent covenants not only  
17 ignores the verdict, which is now final, but ignores the plain  
18 language of the lease, expressly imposing the duty on Excel to  
19 protect the exclusive use right.

20       2. Waiver of Section 4.5.

21 Flagship argues that Excel waived the defense of Section 4.5  
22 by not presenting the issue to the jury and that Excel has the  
23 burden of establishing that Section 4.5 operated as a waiver of  
24 the right to rescind by clear and convincing evidence.

25 Excel rejoins that the Ninth Circuit "specifically ruled  
26 that § 4.5 was not an affirmative defense (affirming this Court's

1 earlier ruling)." The Ninth Circuit, in reversing the finding  
2 of judicial estoppel, ruled that there was no evidence that the  
3 Court relied on any inconsistent statement by Excel: "Excel had  
4 no legal obligation to pursue a general legal argument against  
5 rescission prior to its more narrow arguments because the  
6 argument regarding limitation of remedies available under the  
7 contract is not an affirmative defense under Fed. R. Civ. P.  
8 8(c)."

9 In the November 19, 2004 Memorandum Decision, 40:3-41:26,  
10 the Court addressed Flagship's contention that Sections 4.5 and  
11 22.25 were affirmative defenses that were waived by Excel by  
12 failure to raise them in the Answer. The discussion in the  
13 November 19, 2004 Memorandum Decision is limited to contractual  
14 limitation of damages clauses:

15 With respect to contractual limitations on  
damages in a contract dispute, the defense is  
16 contained in the cause of action itself.  
Both sides had full access to the Lease (38  
17 pages long) and are presumed to have examined  
it carefully. There is no danger of unfair  
surprise by assertion of this defense.

19 This discussion is limited to Section 22.25 of the Lease; it does  
20 not address Section 4.5 as an affirmative defense. Excel relies  
21 on the Ninth Circuit's ruling to assert that it had no burden of  
22 proof "with respect to this issue or other purported 'waiver'  
23 issues proffered by Plaintiffs." Excel contends that the burden  
24 is on Flagship to prove their entitlement to rescission.

25 Flagship's waiver argument is premised on the contention  
26 that application of Section 4.5 to bar rescission is Excel's

affirmative defense. The Ninth Circuit's ruling resolves Flagship's position.<sup>2</sup>

Excel previously argued that "[i]n § 4.5 Plaintiffs have expressly waived the right to 'quit, terminate or surrender' the Lease 'except as otherwise expressly set forth herein' and there is not 'otherwise' in the Lease" and that Section 4.5 precludes rescission "' ... by reason of ... any restriction or prevention of or interference with any use of the Premises.'"

Flagship argues that Section 4.5's plain language reveals that it does not constitute a waiver of rescission. Flagship notes that the term "rescission" does not appear in Section 4.5 and cites California case law in support of its contention that the terms "quit," "terminate," or "surrender" are not synonyms for rescission and have distinct unrelated meanings within the context of the Lease.

Flagship invokes principals of contract interpretation.

In California, "the intention of the parties as expressed in the contract is the source of contractual rights and duties. A court must ascertain and give effect to this intention by determining what the parties meant by the words they used."

*Pacific Gas and Electric Co. v. G.W. Thomas Drayage & Rigging Co., Inc.*, 69 Cal.2d 33, 38 (1968). "The precise meaning of any

<sup>2</sup>The Ninth Circuit's ruling makes unnecessary any discussion of Flagship's contention that Excel waived the right to contest rescission by failing to present the issue to the jury and establishing that Section 4.5 operated as a waiver of rescission by clear and convincing evidence.

1 contract . . . , depends upon the parties' expressed intent, using  
2 an objective standard." As explained in *Waller v. Truck Ins.*  
3 *Exchange, Inc.*, 11 Cal.4th 1, 18-19 (1995):

4 The fundamental rules of contract  
5 interpretation are based on the premise that  
6 the interpretation of a contract must give  
7 effect to the 'mutual intention' of the  
8 parties. 'Under statutory rules of contract  
9 interpretation, the mutual intention of the  
10 parties at the time the contract is formed  
11 governs interpretation. [Civ.Code, § 1636.]  
12 Such intent is to be inferred, if possible,  
13 solely from the written provisions of the  
14 contract. [Id., § 1639.] The 'clear and  
15 explicit' meaning of these provisions,  
16 interpreted in their 'ordinary and popular  
sense,' unless 'used by the parties in a  
technical sense or a special meaning is given  
to them by usage' (*id.*, § 1644), controls  
judicial interpretation . . . A [contract]  
provision will be considered ambiguous when  
it is capable of two or more constructions,  
both of which are reasonable . . . But language  
in a contract must be interpreted as a whole,  
and in the circumstances of the case, and  
cannot be found to be ambiguous in the  
abstract . . . Courts will not strain to create  
an ambiguity where none exists.

17 "Interpretation of a contract 'must be fair and reasonable, not  
18 leading to absurd conclusions'" and a court "'must avoid an  
19 interpretation which will make a contract extraordinary, harsh,  
20 unjust, or inequitable.'" *ASP Properties Group v. Fard, Inc.*,  
21 133 Cal.App.4th 1257, 1269 (2005):

22 Section 1643 provides: 'A contract must  
23 receive such an interpretation as will make  
24 it lawful, operative, definite, reasonable,  
25 and capable of being carried into effect, if  
26 it can be done without violating the  
intention of the parties.' In the event  
other rules of interpretation do not resolve  
an apparent ambiguity or uncertainty, 'the  
language of a contract should be interpreted

most strongly against the party who cause the uncertainty to exist.' (§ 1654).

Id.

Flagship argues that, applying these rules of contract interpretation, Section 4.5 cannot be reasonably interpreted as a waiver of its right to rescind or as precluding rescission in any way. Flagship contends that Excel waived the right to argue that extrinsic evidence should be considered in interpreting the Lease because it did not present extrinsic evidence at trial concerning the meaning of the Lease or request findings of fact by the jury through special interrogatories.

Flagship contends that the plain language of Section 4.5 does not constitute a waiver of its right to rescind.<sup>3</sup>

Flagship asserts the word "terminate" is not synonymous with "rescission." Flagship cites *Welles v. Turner Entertainment Co.*, 503 F.3d 728 (9<sup>th</sup> Cir.2007). In *Welles*, the daughter of Orson Welles sought a declaratory judgment that she owned the copyright and home video rights to "Citizen Kane," an accounting of royalties, and for alleged breach of contract and unfair business practices. In pertinent part, the Ninth Circuit ruled:

As noted above, the Exit Agreement stated that it was 'the mutual desire of the parties to terminate and cancel' their prior agreements. Beatrice Welles argues that this language rescinded the parties' prior agreements and thus returned any right Orson

<sup>3</sup>Flagship requests the Court take judicial notice of various definitions of "rescission," or "rescind," "quit," "terminate" and "surrender" set forth in various recognized dictionaries. See Doc. 501.

1           Welles and Mercury had in the *Citizen Kane*  
2 motion picture to them. However, under  
3 California law, it seems that 'terminate' and  
4 'cancel' mean something different from  
5 'rescind':

6           The words "terminate," "revoke,"  
7 and "cancel," ... all have the same  
8 meaning, namely, the abrogation of  
9 so much of the contract as might  
remain executory at the time notice  
is given, and must be sharply  
distinguished from the word  
"rescind," ... which conveys a  
retroactive effect, meaning to  
restore the parties to their former  
position.

10          *Grant v. Aerodraulics Co.*, 91 Cal.App.2d 68  
11 ... (1949). Thus, under California law, the  
12 Exit Agreement prospectively terminated and  
13 cancelled Orson Welles's right to royalties,  
but did not retroactively rescind RKO's  
copyright in the *Citizen Kane* motion picture  
unless RKO's copyright remained executory at  
the time of the Exit Agreement.

14          503 F.3d at 738. See also *Sanborn v. Ballanfonte*, 98 Cal.App.  
15 482, 488 (1929).

16          Flagship argues that the Lease uses the word "terminate"  
17 consistently with its definition under California law as  
18 explained in *Sanborn* and *Grant*. Flagship refers to Section 18.2  
19 of the Lease, captioned "Remedies:"

20          (a) If an Event of Default shall occur, then,  
21 in addition to any other remedies available  
22 to Landlord at law or in equity, Landlord  
23 shall have the right to immediately terminate  
this Lease, and to recover from the Tenant  
the following:

24           (1) the worth at the time of award  
25 of the unpaid Basic Rent, Additional Rent,  
and other sums owing by Tenant under this  
Lease (collectively 'Rent') which had been  
26 earned at the time of termination;

(2) the worth at the time of award of the amount by which the Unpaid Rent would have been earned after termination until the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided.

• • • •

Flagship also refers to Section 6.4 of the Lease, captioned "Cessation of Business:"

If, after the Commencement Date, Tenant ceases business from the Premises for a period of one hundred eighty (180) days in any sixty (60) month period, Landlord shall have the option, by written notice to Tenant, to terminate this Lease as of the date set forth in such notice, which date shall not be earlier than thirty (30) days after the date of such notice. In the event Landlord elects to terminate this Lease as described above, this Lease shall be null and void and of no further force or effect on the date set forth for such termination, except that accrued but unpaid or unperformed obligations shall continue in effect; provided, however, that Landlord shall pay to Tenant on the effective termination date the unamortized cost incurred by Tenant for the construction of the improvements ....

Flagship refers to Section 15 of the Lease, captioned "Eminent Domain," and specifically Sections 15.1(a) ("In the event of a Total Taking of the Premises, the Lease shall terminate as of the date of the Taking . . .") and 15.2(a) ("If a Partial Taking results [in specified loss of parking or premises], then Tenant may, at Tenant's option, terminate this Lease in its entirety as of the date of the Taking, in which case Landlord and Tenant shall be released from all further obligations and liability under the Lease . . ."). Flagship argues that interpretation of

1 the word "terminate" in Section 4.5 to have a different meaning  
2 from these Lease provisions violates a basic premise of contract  
3 interpretation law. See *E.M.M.I. Inc. v. Zurich American Ins.*  
4 Co., 32 Cal.4th 465, 475 (2004):

5 Accepting Zurich's interpretation would  
6 require that we give different meanings to  
7 the same term used in the same policy  
8 paragraph. This would run afoul of the rule  
9 of contract interpretation that the same word  
10 used in an instrument is generally given the  
11 same meaning unless the policy indicates  
12 otherwise.

13 Flagship also contends that the term "surrender" is not  
14 synonymous with "rescission." Flagship cites *Scott v. Mullins*,  
15 211 Cal.App.2d 51, 55 (1962):

16 A surrender is a yielding up of an estate for  
17 life or years to the reversioner or  
18 remainderman. A surrender yields the estate  
19 as distinguished from the possession and can  
20 be accomplished by express consent of the  
21 parties in writing, or by operation of law  
22 when the parties do something which implies  
23 they have consented.

24 "In landlord-tenant law, surrender exists when the tenant  
25 voluntarily gives up possession of the premises prior to the full  
term of the lease and the landlord accepts possession with intent  
that the lease be terminated." *Black's Law Dictionary* at 1444  
(6<sup>th</sup> ed.1990).

26 Flagship also contends that the term "surrender" in the  
Lease is used consistently with the definition under California  
law. Flagship refers to Section 22.5 of the Lease, captioned  
"Removal of Trade Fixtures During Term; Delivery at End of Term:"

At any time during the Term of the Lease,

1           Tenant may remove from the Premises any trade  
2 fixtures, machinery or equipment belonging to  
3 Tenant or third parties, provided Tenant  
4 shall repair any damage to the Premises  
5 caused by such removal. Upon expiration or  
earlier termination of this Lease, Tenant  
shall surrender the Premises ... and all  
portions thereof, to Landlord in good order,  
condition and repair ....

6 Section 22.11 of the Lease, captioned "Modification; Acceptance  
7 of Surrender," provides:

8           No modification, amendment, termination or  
9 surrender of this Lease or surrender of the  
10 Premises or any portion thereof or of any  
11 interest therein by Tenant shall be valid or  
12 effective unless agreed to and accepted in a  
writing signed by Landlord, and no act by any  
representative or agent of Landlord, other  
than such a written agreement and acceptance  
by Landlord, shall constitute an agreement  
thereto or acceptance thereof.

13           Flagship argues that the term "quit" is not synonymous with  
14 rescission. Flagship cites *Grand Central Public Market v.*  
15 *Kojima*, 11 Cal.App.2d 712, 717 (1936). In *Kojima*, the landlord  
16 sent two three day notices to its tenant to pay rent or quit.  
17 The notices were ignored by the tenant and not acted upon by the  
18 landlord and expired by their terms. The landlord then sent the  
19 tenant a letter stating that if back rent was not paid, the  
20 landlord would commence suit to remove the tenant from the  
21 premises. The landlord sued the tenant, who quit the premises  
22 the day after the suit was filed. The tenant argued that it was  
23 not liable for the rent for the month of January, because the  
24 lease terminated when he quit the premises. The Court of Appeal  
25 ruled:  
26

1       The lease is terminated only if the notice is  
2       acted upon by one of the parties. If the  
3       lessor had brought an unlawful detainer suit  
4       based upon the notices to quit, as they were  
5       framed in this case, then the court trying  
6       such unlawful detainer action would, upon a  
7       proper showing, have the undoubted right to  
8       decree a forfeiture of the lease ... Or, if  
9       the lessee within the three-day period  
10      specified in the notices had quit the  
11      premises, the respective lease would have  
12      been forfeited by agreement of the parties,  
13      since the lessee would be in the position of  
14      accepting lessor's offer to terminate the  
15      same ... Neither of these methods was  
16      followed or taken advantage of by either of  
17      the parties. When a lessor, as did the  
18      lessor in this case, claims or collects rent  
19      in an action, or otherwise, as the result of  
20      a legal proceeding, or otherwise, he waives  
21      his existing right to effect a termination.

22 Flagship relies on this to argue that the physical act of  
23 quitting the premises in and of itself does not effect  
24 termination of a lease: "Similarly, prohibition on 'quitting' the  
25 premises or a waiver of one's right to 'quit' the premises in no  
way could be interpreted as a waiver of one's right to rescind  
the lease."

26       Excel responds that Flagship's "hyper-technical argument"  
27 based on the definitions of "terminate," "surrender" or "quit"  
28 does not address the meaning of Section 4.5 as a whole. Excel  
29 asserts that Flagship's "convoluted argument boils down to the  
30 contention that because § 4.5 does not contain the word  
31 'rescission,' rescission is not barred." Excel refers to the  
32 November 19, 2004 Memorandum Decision discussing the effect of  
33 rescission on contractual clauses at 41:18-44:25:

34       With respect to § 4.5, Defendants cite a

1                   California Court of Appeals opinion which  
2                   states an alternate holding for denying  
rescission:

3                   In plaintiffs' closing brief, not  
4                   before, our attention was drawn to  
a provision contained in the  
5                   subcontract agreement of plaintiff  
....: 'Subcontractor, in the event  
of any dispute or controversy with  
Contractor or any other  
6                   subcontractor over any matter  
whatsoever, shall not cause any  
7                   delay or cessation in or of  
Subcontractor's work or the work of  
8                   any other subcontractor or of the  
Contractor but shall proceed under  
9                   this Subcontract Agreement with the  
performance of the work required  
10                  thereby.'

11                  The quoted clause bound  
12                  [Subcontractor] to finish its work  
regardless of any dispute with  
13                  [Contractor]. In effect, the  
clause was an advance waiver of any  
14                  right to rescind after partial  
performance. The net result of the  
15                  clause was to make a breach of  
contract action the subcontractor's  
16                  exclusive remedy. (*Nelson v.*  
Spence, 182 Cal.App.2d 493, 497  
17                  ...; 5A Corbin on Contracts, §  
1227; 17A C.J.S., Contracts, §  
18                  422[1], p. 521, fn. 62.). Having  
committed itself to complete  
19                  performance, [Subcontractor] was  
confined to the remedy and to make  
20                  the scale of damages available to  
one who has completed his contract  
notwithstanding a breach by the  
21                  other party - suit on the contract  
and recovery by the scale of  
22                  damages which the law applies in  
such suits.

24                  *B.C. Richter Contracting Co. v. Continental*  
Casualty Co., 230 Cal.App.2d 491, 500-501  
25                  (Cal.Ct.App. 1964). The provision waiving  
rescission was applicable even though it was  
26                  first noticed on appeal after the completion

1 of a bench trial. The cited provision does  
2 not mention the term 'rescission' and was  
3 found to be a valid waiver of that remedy.  
4 Its language is comparable to § 4.5.

5 The opinion upheld a valid anti-rescission  
6 clause, although rescission would void the  
7 effect of all other contractual clauses. The  
8 cases Plaintiff cite to the contrary do not  
9 negate the ability to waive the remedy of  
10 rescission. See e.g. *Guerini Stone Co. v.*  
11 *P.J. Carlin Constr. Co.*, 248 U.S. 334, 341  
12 (1919) (subcontractor properly terminated  
13 contract when project was indefinitely  
14 delayed; 'the 11<sup>th</sup> paragraph of the sub-  
15 contract, providing: "The general contractors  
16 will provide all labor and materials not  
17 included in this contract in such manner as  
18 not to delay the material progress of the  
19 work, and in the event of failure so to do,  
20 thereby causing loss to the sub-contractor,  
21 agree that they will reimburse the sub-  
22 contractor for such loss," as applied to the  
23 facts of the case, imported an agreement by  
24 defendant to furnish the foundation in such  
25 manner that plaintiff might build upon it  
26 without delay, and was inconsistent with an  
implication that the parties intended that  
delays attributable to the action of the  
owner should leave plaintiff remediless');  
*Gally v. Wynne*, 96 Cal.App. 145, 147  
(Cal.Ct.App. 1929) (the contract provision in  
question stated 'In the event I violate any  
part of this agreement I agree to deduct \$500  
from the purchase price of \$3500,' which is  
not an anti-rescission clause); *Dyer Bros.*  
*Golden West Iron Works v. Central Iron Works*,  
72 Cal.App. 202, 207 (Cal.Ct.App.1925) (both  
parties breached the contract, voiding the  
liquidated damages clause).

21 The *B.C. Richter* holding cited by Defendants  
22 has been affirmed by more recent opinions.  
See *Fosson v. Palace (Waterland), Ltd.*, 78  
23 F.3d 1448, 1455 (9<sup>th</sup> Cir.1996) ('Fosson  
admitted that he read and understood the  
Synch License provision in which he waived  
his right to rescind or terminate the  
agreement .... Thus, Fosson has no right to  
rescind as a matter of law by virtue of his  
waiver.); *Michel & Pfeffer v. Oceanside*

Properties, Inc., (1976) 61 Cal.App.3d 433, 442 (specifically distinguishing *Guerini* as not mandating the performance of the contract, hence no waiver of rescission). These cases affirm the general enforceability of an anti-rescission clause.

Excel asserts that Flagship cites no authority that requires the explicit use of the term "rescission" in order to bar rescission as a remedy. Excel contends the result reached in *B.C. Richter* should apply here, "because all facets of rescission are barred by § 4.5."

Flagship replies that Excel's reliance on *B.C. Richter* and the November 19, 2004 Memorandum Decision is misplaced. Flagship contends that Excel argued to the Ninth Circuit on appeal that the Court correctly determined that Section 4.5 barred rescission based on *B.C. Richter* and the other cases cited in the November 19, 2004 Memorandum Decision. Excel contended on appeal that, had it not been for the finding of judicial estoppel, Section 4.5 would have prevented rescission. The Ninth Circuit remanded "so that the district court may determine in the first instance whether the contract, in its entirety, allows for rescission and whether California law would give effect to the lease's limitations on remedies in this circumstances." Implicit in these instructions, Flagship contends, is a rejection of Excel's position that *B.C. Richter*, *Fosson*, and *Michel & Pfeffer* require, as a matter of law, that Section 4.5 be interpreted as a waiver of rescission."

Flagship argues that the circumstances of the cases on which

1 Excel relies are different from the facts of this case:  
2 "[n]either *B.C. Richter, Fosson*, nor *Michel & Pfeffer* involved a  
3 landlord's undisputed material breach of a 25 year ground lease a  
4 year after the lease commenced."

5 In *Fosson* a composer brought a copyright infringement action  
6 against movie producers and a financing company. The District  
7 Court granted summary judgment for defendants. On appeal, the  
8 Ninth Circuit addressed the circumstances under which a  
9 subsequent breach of an express license, which may constitute  
10 grounds for rescission, can give rise to a suit for infringement  
11 by the licensor. Flagship argues that *Fosson* is distinguishable  
12 because there, the remedies limitation clause specifically  
13 provided that the licensor "shall not have any right to terminate  
14 or rescind this Agreement" and because *Fosson* admitted that he  
15 read and understood the agreement. Flagship notes that Section  
16 4.5 does not mention the term "rescission" and contends that  
17 there is no testimony in this action regarding any party's  
18 understanding of Section 4.5.

19 In *Michel & Pfeffer*, a subcontractor on a building project  
20 brought an action against the contractor, the contractor's  
21 surety, and the property owners for payment on a bond,  
22 foreclosure of a mechanic's lien, and a common count based on  
23 work performed. Flagship contends: "These circumstances alone  
24 point to why remedies' limitation clauses in construction  
25 contracts may be generally enforced, as the subcontractor has  
26 both the security of the bond and mechanics lien statutes to

1 secure payment for his work done." Flagship asserts that also at  
2 issue in *Michel & Pfeffer* was a delay of the subcontractor's work  
3 caused by the contractor. The contract provided that an  
4 extension of time for delays "shall be the sole remedy of  
5 Subcontractor." Flagship argues that *Michel & Pfeffer* is  
6 distinguishable because Section 4.5 does not provide for any sole  
7 remedy for the landlord's breach and does not reference or  
8 otherwise pertain to the landlord's obligation to honor  
9 Flagship's exclusive use rights.

10       B.C. Richter involved actions by subcontractors on the prime  
11 contractor's surety bond for quantum meruit recovery to be  
12 measured by the reasonable value of unpaid labor and materials.  
13 The trial court ruled that the subcontractors' recovery was  
14 limited to the unpaid remainder of the contract price. On  
15 appeal, the subcontractors argued that the breaches and defaults  
16 by the contractor entitled them to forego the contract price as  
17 the strict measure of liability, permitting recovery by the more  
18 generous scale of quantum meruit or reasonable value. The Court  
19 of Appeal ruled:

20           Plaintiffs' thesis rests upon misconceptions  
21 of contract law and misuse of the phrase  
22 'quantum meruit.' The general rule in  
23 California is "'... one who has been injured  
24 by a breach of contract has an election to  
25 pursue any of three remedies, to wit: 'He may  
26 treat the contract as rescinded and may  
recover upon a quantum meruit so far as he  
has performed; or he may keep the contract  
alive, for the benefit of both parties, being  
at all times ready and able to perform; or,  
third, he may treat the repudiation as  
putting an end to the contract for all

1           purposes of performance, and sue for the  
2           profits he would have realized if he had not  
3           been prevented from performing.''' ... When,  
4           after partial performance, the innocent party  
5           elects to disaffirm or rescind, there is no  
6           longer any contract which conclusively fixes  
7           a limit upon his recovery; hence, it is said,  
8           he may sue upon a quantum meruit as if the  
9           special contract had never been made and may  
10          recover the reasonable value of the services  
11          performed, even though recovery exceeds the  
12          contract price ....

13          If the innocent party chooses to rescind, he  
14          must do so promptly upon discovery of the  
15          breach ... He may not wait to see whether the  
16          contract turns out to be profitable or  
17          unprofitable, good or bad ....

18          Where his performance is not prevented, the  
19          injured party may elect instead to affirm the  
20          contract and complete performance. If such  
21          is his election, his exclusive remedy is an  
22          action for damages ... Affirmation of the  
23          contract, on the one hand, and rescission and  
24          restitution on the other, are alternative  
25          remedies. Election to pursue one is a bar to  
26          invoking the other ....

27          In plaintiffs' closing brief, not before, our  
28          attention was drawn to a provision contained  
29          in the subcontract agreement of plaintiff  
30          B.C. Richter Contracting Company, but not in  
31          the subcontract of R. & E. Materials Company:  
32          'Subcontractor, in the event of any dispute  
33          or controversy with Contractor or any other  
34          subcontractor over any matter whatsoever,  
35          shall not cause any delay or cessation in or  
36          of Subcontractor's work or the work of any  
37          other subcontractor or the Contractor but  
38          shall proceed under this Subcontract  
39          Agreement with the performance of the work  
40          required thereby.'

41          The quoted clause bound Richter to finish its  
42          work regardless of any dispute with Hayes-Cal  
43          Builders. In effect, the clause was an  
44          advance waiver of any right to rescind after  
45          partial performance ... Having committed  
46          itself to complete performance, Richter  
47          Contracting was confined to the remedy and to

1           the scale of damages available to one who has  
2           completed his contract notwithstanding a  
3           breach by the other party - suit on the  
4           contract and recovery by the scale of damages  
5           which the law applies in such suits ....

6           On the assumption that Hayes-Cal was guilty  
7           of hindrances and defaults amounting to a  
8           breach of contract conditions, the other  
9           plaintiff, R. & E. Materials Company, had an  
10          election to rescind promptly or to stand on  
11          its contract and continue performance.

12          Choice of the first alternative would have  
13          permitted R. & E. Materials to sue in quantum  
14          meruit for the reasonable value of partial  
15          performance, less any sums paid. The joint  
16          venture did not choose that alternative. The  
17          trial court correctly concluded that it lost  
18          all right to rescind by failing to do so  
19          promptly after the cessation of progress  
20          payments. It is equally accurate to say that  
21          it elected not to repudiate the subcontract,  
22          but to affirm it and continue performance.  
23          Having chosen the second alternative, it was  
24          then barred from repudiation and pursuit of  
25          reasonable value.

26          Thus, when both plaintiffs argue on appeal  
27          for 'quantum meruit' unlimited by the  
28          contract price, they speak in terms not  
29          available to them. Their remedy was that  
30          imposed upon them, in the one case, by the  
31          contract and in the other by their election  
32          to perform: to sue for the unpaid balance of  
33          the contract price plus extra costs caused by  
34          hindrances and delay.

35          230 Cal.App.2d at 499-501.

36          Flagship asserts that the court in *B.C. Richter* did not find  
37          that the remedies provision barred rescission outright. *B.C.*  
38          *Richter* ruled that the "clause bound Richter to finish its work  
39          regardless of any dispute with Hayes-Cal Builders" and that  
40          "clause was an advance waiver of any right to rescind after  
41          partial performance." 230 Cal.App.2d at 501. Flagship contends  
42

1 that *B.C. Richter* does not support interpreting Section 4.5 as a  
2 waiver of Flagship's right to rescind, particularly in light of  
3 the fact that in *B.C. Richter*, there was no material breach by  
4 the other contracting party that thwarted performance. Flagship  
5 asserts:

6 Significantly, *B.C. Richter* had completed the  
7 contract and then sought to rescind the  
8 contract. (*Id.* at 502.) The court found  
that under these circumstances, the  
subcontractor had waived its right to  
rescind.

9 Flagship cites *Seaboard Surety Co. v. United States*, 355  
10 F.2d 139, 143 (9<sup>th</sup> Cir.1966), where the Ninth Circuit, in  
11 discussing *B.C. Richter*, stated that "[t]he subcontractors had a  
12 right to rescind after the cessation of certain progress  
13 payments, but elected to proceed with contract and completed  
14 performance."

15 Flagship also cites *Barton Properties, Inc. v. Superior*  
16 *Gunite Co.*, 2006 WL 541025 at \*7 (Cal.Ct.App.2006).

17 The dispute in *Barton Properties* was over paragraph 35 of a  
18 construction contract:

19 35. In the event of a dispute between the  
20 parties as to performance of the work, the  
interpretation of this contract, extra work,  
delay, disruption, or payment or nonpayment  
for work performed, the parties shall attempt  
to resolve the dispute by negotiation. If  
the dispute is not resolved, Contractor  
agrees to Continue the work diligently to  
completion and will neither rescind nor stop  
the progress of the work, but will submit  
such controversy to determination by a court  
of competent jurisdiction after the project  
has been completed.

1   *Id.* at \*5. The Court of Appeal, citing California Civil Code §  
2   1511 and *Peter Kiewit Sons' Co. v. Pasadena Junior College*, 59  
3   Cal.2d 241 (1963), that an owner who is a party to a construction  
4   contract is a creditor, ruled:

5           We conclude that where a general contractor  
6           (Barton Properties) materially breaches a  
7           contract so as to delay or prevent the  
8           performance of the subcontract (Superior  
9           Gunite) the subcontractor is not foreclosed  
10          from refusing to perform and rescinding the  
11          contract by reason of a contractual  
12          provision, such as paragraph 35, which  
13          requires a contractor not to rescind the  
14          contract or stop working but instead to  
15          'continue the work diligently to completion'  
16          and then 'submit [any] controversy  
17          [regarding]' 'performance of the work, the  
18          interpretation of this contract, extra work,  
19          delay, disruption, or payment or nonpayment  
20          for work performed' 'to determination by a  
21          court of competent jurisdiction after the  
22          project has been completed.' A contrary  
23          conclusion would impermissibly conflict with  
24          the controlling plain language of section  
25          1511, paragraph 1 ....

26           Barton Properties acknowledges the existence  
27          of this conflict. Its position is that the  
28          1965 amendment to section 1511, paragraph 1  
29          'added [a] clause permitting ... provisions'  
30          such as paragraph 35.

31           We note Barton Properties has cited no  
32          applicable authority in support of its  
33          position that contractual provisions such as  
34          paragraph 35 are authorized under section  
35          1511, paragraph 1. Its reliance is misplaced  
36          on *B.C. Richter Contracting Co. v.*  
37          *Continental Cas. Co.* (1964) 230 Cal.App.2d  
38          491 ... and *Michel & Pfeffer v. Oceanside*  
39          *Properties, Inc.* (1976) 61 Cal.App.3d 433.  
40          Neither case addressed section 1511,  
41          paragraph 1, much less its impact on a  
42          contractual provision such as paragraph 35  
43          ....

44           *Id.* at \*6. The Court of Appeal then addressed Barton Properties'

1 contention that it was prejudiced by a jury instruction that it  
2 contended negated paragraph 35. In so ruling, the Court of  
3 Appeal stated:

4 And *B.C. Richter* is factually inapplicable  
5 and thus fails to support Barton Properties's  
6 position. As discussed above, *B.C. Richter*  
7 did not involve section 1511, paragraph 1 or  
8 its applicability to paragraph 35 or a  
similar contract provision, and its comments  
regarding such a provision were dicta. The  
court did not discuss whether section 1511,  
paragraph 1 rendered unenforceable a contract  
provision like paragraph 35. In [*B.C.*  
*Richter*], two subcontractors sued in quantum  
meruit for an amount greater than the  
contract price on the theory they were  
entitled to rescind the contract ... Their  
exclusive remedy, however, was for breach of  
contract because they affirmed the contract  
by completing their performance ... The *B.C.*  
*Richter* court characterized a clause in the  
contract of one subcontractor, which required  
it to complete its performance  
notwithstanding any dispute with the  
contractor, to be an 'advance waiver of any  
right to rescind after partial performance[,  
which meant] a breach of contract action  
[was] the subcontractor's exclusive remedy.'

... But this was dicta because the trial  
court did not make any factual findings that  
the contractor had hindered the  
subcontractor's performance, and the  
subcontractor had performed completely.

19 *Id.* at \*7.

20 Barton Properties is not controlling. California Civil Code  
21 § 1511 provides:

22 The want of performance of an obligation, or  
23 an offer of performance, in whole or in part,  
24 or any delay therein, is excused by the  
following causes, to the extent to which they  
operate:

25 1. When such performance or offer is  
26 prevented or delayed by the act of the

1 creditor, or by the operation of law, even  
2 though there may have been a stipulation that  
3 this shall not be an excuse; however, the  
4 parties may expressly require in a contract  
5 that the party relying on the provisions of  
6 this paragraph give written notice to the  
7 other party or parties, within a reasonable  
time after the occurrence of the event  
excusing performance, of an intention to  
claim an extension of time or of an intention  
to bring suit or any other similar or related  
intent, provided that the requirement of such  
notice is reasonable and just ....

8 As Excel notes, Flagship and Excel were tenant and landlord.  
9 Flagship makes no showing or argument that it was a creditor  
10 within the meaning of Section 1511.

11 The rules of contract construction support Flagship's  
12 position that Section 4.5 is not a waiver of rescission; the  
13 unavailability of rescission is never mentioned in Section 4.5  
14 and no evidence was presented that the parties intended that  
15 rescission of the lease be precluded based on Excel's material  
16 breach of the lease. Moreover, *B.C. Richter* and related cases  
17 contain continual performance obligations, despite an event of  
18 breach, which is the basis for a waiver of the right to rescind.  
19 Section 4.5 is expressly subject to exceptions "otherwise  
20 expressly set forth herein." Section 6.3 is such an express  
21 exception.

22       3. Rescission Voided Entire Lease.

23       Flagship argues that, because it rescinded the Lease, the  
24 entire Lease, including Section 4.5, is extinguished and cannot  
25 be enforced.

26       California Civil Code § 1688 provides that "[a] contract is

1 extinguished by rescission." "Rescission of a contract must be  
2 of the contract as a whole and not in part. It is the undoing of  
3 a thing and means that both parties to the contract are entirely  
4 released as if it had not been made." *Douglas v. Dahm*, 101  
5 Cal.App.2d 125, 128 (1950). Flagship refers to the November 19,  
6 2004 Memorandum Decision at 41:28-42:17, where the Court  
7 discussed the effect of rescission on contractual clauses:

8 Plaintiffs are correct in stating that  
9 rescission would void ordinary contractual  
10 clauses such as § 22.25. Once a contract is  
11 rescinded, all its provisions cease to have  
12 effect. See *Larsen v. Johannes*, 7 Cal.App.3d  
13 491, 501 (Cal.Ct.App. 1970) (citing *Lemle v.*  
14 *Barry*, 181 Cal. 1, 5 (Cal.1919)). ('When a  
15 contract is rescinded, it ceases to exist.  
16 If the action to rescind or an action based  
17 on an alleged rescission or abandonment is  
18 successful, the contract is forever ended and  
19 its covenants cannot thereafter be enforced  
20 by any action'). In an unpublished state  
court opinion, an analogous question was  
posed: 'The issue presented is elemental -  
may a defendant resist an action for  
rescission by relying on a liquidated damages  
provision of the contract the plaintiff is  
seeking to rescind? The answer is equally  
simple - no.' *BTS, Inc. v. Sonitrol Corp. of*  
*Contra Costa*, No. 1093591, 2002 WL 234889  
(Cal.App. 1 Dist., Feb. 19, 2002) ('rescinded  
contract is an extinguished contract meaning  
that it has ceased to exist and none of its  
provisions can be enforced by any party').

21 Excel responds that Flagship's position evades "the point  
22 entirely: § 4.5 bars rescission from the outset, so what *might*  
23 happen if Plaintiffs could rescind is meaningless." Excel  
24 asserts that Flagship's "circular argument" was rejected by the  
25 Court in the November 19, 2004 Memorandum Decision discussing the  
26 effect of rescission on contractual clauses quoted above. This

1 is belied by the express exceptions included in Sections 4.5 and  
2 6.3, which suspend the Lessor's remedies upon occurrence of the  
3 condition of the exception; to wit, Excel's violation of  
4 Flagship's exclusive use rights.

5

6       4. Context of Lease as a Whole Does Not Support  
7 Interpreting Other Portions of Section 4.5 as Waiver of Right to  
8 Rescind.

9       Flagship argues that, looking to the Lease as a whole,  
10 Section 4.5 cannot be interpreted as a waiver of the right to  
11 rescind. Flagship notes that Section 4 of the Lease is captioned  
12 "Rent." The provisions of Section 4 are specifically directed at  
13 the Tenant's obligations to pay rent: Section 4.1 sets out the  
14 preliminary rent Flagship was obligated to pay from the time it  
15 entered into the Lease until the Golden Corral Restaurant opened  
16 for business; Section 4.2 sets out the basic rent after the  
17 restaurant opened; Section 4.3 provided for the amount of rent  
18 during the five-year option periods; Section 4.4 obligated  
19 Flagship to pay additional rent on demand; Section 4.6 provided  
20 Landlord the right to assign rent payments. Flagship argues that  
21 within the context of these provisions, Section 4.5, captioned  
22 "Triple Net Lease," provides what Excel would net from the rental  
23 payments. Flagship cites 6 Matthew Bender, California Real  
24 Estate Law & Practice, § 154.10[1], that a triple net lease  
25 provision assures the Landlord that "the tenant pays the taxes,  
26 the insurance, costs of repair, and costs of maintenance."

1 Flagship argues that Section 4.5 is a standard triple net lease  
2 provision which entitles the Landlord to rent net of these costs  
3 and "is essentially a financing device that gives the tenant the  
4 advantages of ownership without the investment of capital or  
5 direct obligation under a deed of trust and gives the owner of  
6 the property a return of his or her investment without the active  
7 responsibilities of investment management." *Id.*

8 Flagship refers to the portion of Section 4.5 providing:

9       *Except as otherwise expressly set forth in*  
10      *this Lease, this Lease shall continue in full*  
11      *force and effect, and the obligations of*  
12      *Tenant hereunder shall not be released,*  
13      *discharged or otherwise affected, by reason*  
14      *of any of the following: (a) any damage to or*  
15      *destruction of the Premises or any portion of*  
16      *either or any Taking of the Premises or any*  
17      *portion of either; (b) any restriction or*  
18      *prevention of or interference with any use of*  
19      *the Premises or any portion of either; or (c)*  
20      *any other occurrence whatsoever, whether*  
21      *similar or dissimilar to the foregoing, in*  
22      *each case, whether or not Tenant shall have*  
23      *notice or knowledge of any of the foregoing.*  
24      *[Emphasis added].*

25      Flagship argues that nothing in this language can be  
26      interpreted as a waiver of Flagship's right to rescind:

27      On its face, the language deals with physical  
28      interference or restrictions and is facially  
29      not applicable to the material breach of the  
30      lease at issue in this case. By definition,  
31      the provision provides that the lease would  
32      continue in force notwithstanding the  
33      occurrence of a condition subsequent.  
34      Specifically, there is no language contained  
35      within Section 4.5 that could reasonably be  
36      interpreted as a limitation on a tenant's  
37      right to rescind.

38      Flagship argues that the purpose of the provision in Section  
39

1 4.5 that

2 Tenant's Basic Rent and Additional Rent shall  
3 be absolutely net to Landlord, so that this  
4 Lease shall yield to Landlord the full amount  
5 of the installments of Basic Rent and  
6 Additional Rent throughout the Term, and  
7 shall be paid without assertion of any  
counterclaim, set off, deduction or defense  
and without abatement, suspension, deferment,  
diminution, reduction or refund of any kind,  
except as expressly set forth herein,  
[emphasis added]

8 is "to preclude a tenant from interposing a counterclaim in any  
9 action or proceeding brought by the landlord for rent, or for  
10 possession based on nonpayment," quoting 1 Friedman on Leases §  
11 5:1.2[A] (5<sup>th</sup> ed. 2009). Flagship asserts that "[t]his  
12 interpretation flows from the language of the sentence, which  
13 uses the words, 'counterclaim, set off, deduction, or defense,'  
14 and does not use the words typically associated with offensive  
15 action, such as 'cause of action' 'claims' etc." Flagship argues  
16 that this portion of Section 4.5 should be contrasted with  
17 Section 12.1, captioned "General Indemnity:"

18 Tenant shall protect, indemnify, defend and  
19 hold Landlord ... harmless from and against  
any and all liabilities, obligations, claims,  
damages, penalties, causes of action,  
judgments, costs and expenses ... incurred by  
or asserted against Landlord ... during the  
21 Term hereof, arising in connection with or  
resulting from (a) this Lease; (b) any  
accident or injury to or death of persons or  
loss of or damage to property occurring on or  
about the Premises or any portion thereof;  
(c) any use or condition of the Premises or  
any portion thereof; (d) any failure by  
Tenant to perform or comply with any terms of  
this Lease, or (e) any negligence, willful  
misconduct or tortious act or omission on the  
part of Tenant or any Subtenant ... If any

1           action, suit or proceeding is brought against  
2           Landlord ... by reason of any of the  
3           foregoing, Tenant, upon Landlord's request,  
4           shall, at Tenant's sole cost and expense,  
5           defend such action, suit or proceeding with  
          counsel designated by Landlord. The  
          obligations of Tenant under this Paragraph  
          shall survive the expiration or earlier  
          termination of this Lease.

6 Flagship, noting that Section 12.1 uses the terms "any and all  
7 liabilities, obligations, claims, damages, penalties, causes of  
8 action, judgments, costs and expenses," argues that "[u]nder the  
9 rule of construction that the expression of one thing is the  
10 exclusion of another, and in light of Section 4.5's use of the  
11 words typically associated with defenses, such as 'set off,  
12 deduction, defense, abatement, counterclaim' etc., this sentence  
13 cannot be interpreted as applying to offensive claims that  
14 Flagship would have against Defendants for their breach of the  
15 Lease." Flagship cites *Steven v. Fidelity & Cas. Co. of New*  
16 *York*, 58 Cal.2d 862, 870 (1962):

17           The crucial issue resolves into whether the  
18           limitation of that extension to 'land  
19           conveyances' sufficiently overcomes the  
20           normal expectation that coverage would extend  
21           to any reasonable form of substitute  
22           conveyance. The clause clearly does not  
23           specifically exclude substitute emergency  
          aircraft; it does not mention nonland  
          conveyances at all. An inference of such  
          noncoverage could arise only with the aid of  
          the rule of construction *expressio unius est*  
          *exclusio alterius*: i.e., that mention of one  
          matter implies the exclusion of all others.

24           We do not believe the application of the  
25           maxim can resolve the present case. The  
26           maxim serves as an aid to resolve the  
          ambiguities of a contract. If we invoke the  
          *expressio unium* approach, we must necessarily

1 thereby recognize the ambiguity of the  
2 contract; in that event other legal  
3 techniques for the resolution of ambiguities,  
4 including the rule that they should be  
5 interpreted against the draftsman, also come  
6 into play. Thus *McNee v. Harold Hensgen &*  
*Associates* (1960) 178 Cal.App.2d 881 ...  
7 holds that if the applicability of a contract  
provision can be determined only by use of  
the maxim *expressio unius*, the contract is  
ambiguous, and extrinsic evidence is  
therefore admissible to prove the intent of  
the parties.

8 Flagship further asserts that the "and shall be paid" clause of  
9 Section 4.5 refers only to the payment of rent by Flagship and,  
10 standing alone, cannot be construed as a waiver of any right to  
11 rescind the Lease based on Excel's breach of the exclusive use  
12 provision.

13 Finally, Flagship refers to the portion of Section 4.5:  
14 "Under no circumstances whether now existing or hereafter  
15 arising, or whether beyond the present contemplation of the  
16 parties, shall Landlord be required to make any payment or refund  
17 of any kind whatsoever or be under any obligation or liability  
18 hereunder, except as expressly set forth herein." Flagship  
19 argues that this portion of Section 4.5 is not a waiver of the  
20 right to rescind by the Tenant for a material breach of the  
21 Lease:

22 This sentence of Section 4.5 plainly sets out  
23 the obligations of the Landlord to refund or  
24 pay Flagship 'hereunder' i.e., *under the*  
Lease, but has no facial applicability to any  
claims Flagship may have against the Landlord  
for its breach of its obligations under the  
Lease.

26 Flagship again notes that this portion of Section 4.5 does not

1 use the terms damages, judgments, causes of action, or other  
2 similar language used in the indemnity section, Section 12.1.  
3 Flagship refers to Section 15.1(a), which provides that, in the  
4 event of a total Taking of the Premises, "this Lease shall  
5 terminate as of the date of the Taking and the Basic Rent and  
6 Additional Rent theretofore paid or then payable shall be  
7 apportioned and paid up to the date of termination and any  
8 unearned Basic Rent or Additional Rent shall be refunded to  
9 Tenant." Flagship argues that the "payment or refund" sentence  
10 in Section 4.5 cannot be interpreted as waiving Flagship's right  
11 to sue Excel for rescission of the Lease based on Excel's  
12 material breach of the exclusive use provision. Citing *Runyan v.*  
13 *Pacific Air Industries, Inc.*, 2 Cal.3d 304, 310-319 (1970),  
14 Flagship asserts that, in the face of rescission, the plaintiff  
15 is awarded restitution damages, not a refund.

16 Excel responds that the whole of the Lease is consistent  
17 with its position that Flagship's obligations are separate and  
18 independent covenants and that Section 4.5 otherwise bars  
19 rescission. Excel contends that Flagship attempts to skirt the  
20 legal effect of independent covenants and reads the language of  
21 Section 4.5 "so technically and narrowly that the results are  
22 ridiculous." Excel refers to Section 14.3 of the Lease, in the  
23 section captioned "Damage by Fire or Casualty:"

24 Except as expressly provided in this Lease,  
25 Tenant's obligation to make payments of Basic  
26 Rent, Additional Rent and all other charges  
hereunder, except to the extent Landlord is  
actually reimbursed by the proceeds of rental

1           value insurance, and to perform all its  
2           covenants and conditions shall not be  
3           affected by any damage or destruction of the  
4           Premises or the improvements or replacements  
5           thereof. Tenant hereby waives the provisions  
              of any statute or law now or hereafter in  
              effect which is contrary to the foregoing  
              obligation of Tenant, or which relieves  
              Tenant therefrom.

6           Excel asserts that, "[f]ollowing Plaintiffs' absurd logic,  
7           Plaintiffs could rescind the entire Ground Lease in the event of  
8           damage to its Improvements, because the word 'rescission' is not  
9           specifically stated."

10          However, for the reasons stated *supra*, Section 4.5 cannot be  
11          construed to preclude rescission because of Excel's material  
12          breach of the lease. Section 4.5 by its terms provides that the  
13          tenant's obligation to pay rent under the lease is an independent  
14          covenant. Section 4.5 does not refer in any way to the  
15          landlord's obligations to the tenant under the lease. The jury  
16          specifically found that Excel's breach of the exclusive use  
17          provision in Section 6.3 of the lease was material.

18          5. Defendants' Conduct and Performance Shows They  
19          Never Interpreted Section 4.5 as Preventing the Remedy of  
20          Rescission.

21          Flagship argues that Defendants' conduct with respect to  
22          Section 4.5 "is not reasonably interpreted as a waiver of  
23          rescission."

24          Flagship refers to the "principle of practical  
25          construction." Flagship cites *Crestview Cemetery Ass'n v.*  
26          *Dieden*, 54 Cal.2d 744, 753-754 (1960):

1       That the actions of the parties should be  
2       used as a reliable means of interpreting an  
3       ambiguous contract is, of course, well  
4       settled in our law ... 'The acts of the  
5       parties under the contract afford one of the  
6       most reliable means of arriving at their  
7       intention; and, while not conclusive, the  
8       construction thus given to a contract by the  
9       parties before any controversy has arisen as  
10       to its meaning will, when reasonable, be  
11       adopted and enforced by the courts.' ... 'The  
12       reason underlying the rule is that it is the  
13       duty of the court to give effect to the  
14       intention of the parties where it is not  
15       wholly at variance with the correct legal  
16       interpretation of the terms of the contract,  
17       and a practical construction placed by the  
18       parties upon the instrument is the best  
19       evidence of their intention ....'

20       ...

21       This rule of practical construction is  
22       predicated on the common sense concept that  
23       'actions speak louder than words.' Words are  
24       frequently but an imperfect medium to convey  
25       thought and intention. When the parties to a  
26       contract perform under it and demonstrate by  
1       their conduct that they knew what they were  
2       talking about the courts should enforce that  
3       intent.

4       Appellants correctly claim that this doctrine  
5       of practical construction can only be applied  
6       when the contract is ambiguous, and cannot be  
7       used when the contract is unambiguous. That  
8       is undoubtedly a correct general statement of  
9       the law ... But the question involved in such  
10       cases is ambiguous to whom? Words frequently  
11       mean different things to different people.  
12       Here the contracting parties demonstrated by  
13       their actions that they knew what the words  
14       meant and were intended to mean. Thus, even  
15       if it be assumed that the words standing  
16       alone might mean one thing to the members of  
17       this court, where the parties have  
18       demonstrated by their actions and performance  
19       that to them the contract meant something  
20       quite different, the meaning and intent of  
21       the parties should be enforced. In such a  
22       situation the parties by their actions have

1           created the 'ambiguity' required to bring the  
2           rule into operation. If this were not the  
3           rule the courts would be enforcing one  
4           contract when both parties have demonstrated  
5           that they meant and intended the contract to  
6           be quite different.

7           Flagship argues that, under the principle of practical  
8           construction, the Court can consider Excel's conduct after  
9           Flagship's notice of rescission in April 2001, until the dispute  
10          regarding Section 4.5 arose, after the jury's verdict was  
11          returned in Flagship's favor. Flagship argues that, underlying  
12          the rule of practical construction is the recognition that a  
13          party may modify its conduct with respect to the disputed issue  
14          following a disagreement. Flagship asserts that, given Excel's  
15          position that Section 4.5 expressly bars rescission, it is  
16          logical to expect that Excel would have asserted this bar at the  
17          time the parties' dispute arose in 2000 and again in response to  
18          the notice of rescission. Excel never contended that Section 4.5  
19          constituted a waiver of Flagship's right to rescind at any time  
20          before this litigation commenced or at any time before this case  
21          was submitted to the jury: "Clearly, Defendants' assertion that  
22          Section 4.5 bars rescission was an afterthought."

23           Excel responds that Flagship fundamentally misunderstands  
24           the principle of practical construction, which focuses on how the  
25           parties behaved before any controversy erupted:

26           If this doctrine has any application here, it  
27           supports Excel's position, not Plaintiffs.'  
28           This is so because Excel believed that the  
29           Four Seasons' use would not violate  
30           Plaintiffs' lease and Excel acted  
31           accordingly. Obviously, from Excel's point

1           of view at the time, the remedy of rescission  
2           was irrelevant because there was no breach.

3           It is Excel that misinterprets the doctrine. Excel did not  
4           assert that Flagship had no contractual right to rescind the  
5           lease and was limited to damages when Flagship gave notice of  
6           rescission. Excel only made this contention after the jury had  
7           ruled that Excel had materially breached the exclusive use  
8           provision of the lease. If Excel truly believed that rescission  
9           was not an available remedy, Excel would have so advised Flagship  
10          when Flagship gave notice of rescission and sought rescission as  
11          a remedy in its complaint. If Excel had believed in the bar  
12          defense, its conduct is further inconsistent as it never brought,  
13          before or during trial, a dispositive motion on this issue.

14           6. No California Case has Upheld Advance Waiver of  
15          Rescission for Material Breach.

16           In response to Excel's contention that Section 4.5 is an  
17          "express" waiver of Flagship's right to rescind the Lease for  
18          Excel's material breach and citing *Medico-Dental Bldg. Co. of Los*  
19          *Angeles v. Horton & Converse, supra*, 21 Cal.2d at 434, Flagship  
20          asserts that a material breach occurs when the breach "will  
21          defeat the entire object of the lessee in entering into the  
22          lease." Flagship contends that the California Supreme Court  
23          articulated the concept of a material breach:

24           While consistent with practical  
25          considerations, it is said that a breach of a  
26          contractual right in a trivial or  
              inappreciable respect will not justify  
              rescission of the agreement by the party  
              entitled to the benefit in question, a

1 default in performance will not be tolerated  
2 if it is so dominant or pervasive as in any  
3 real or substantial measure to frustrate the  
4 purpose of the undertaking ... But where, as  
5 here, the covenant of the lessor is of such  
6 character that its breach will defeat the  
7 entire object of the lessee in entering into  
the lease, such as rendering his further  
occupancy of the premises a source of  
continuing financial loss incapable of  
satisfactory measurement in damages, it must  
be held that the covenant goes to the root of  
the consideration for the lease upon the  
lessee's part.

8 *Id.* at 433-434. Flagship asserts that Excel's contention that  
9 Flagship waived the right to rescind the agreement based on  
10 Excel's breach of the exclusive use provision would "defeat the  
11 entire object of the lessee in entering into the lease."  
12 Flagship refers to Marvin Reiche's trial testimony that he would  
13 not have entered into the Lease but for the exclusive use granted  
14 to Flagship pursuant to the exclusive use provision.  
15

16 See discussion *infra re* Flagship's argument that there is no  
17 authority indicating that California Courts would interpret  
18 Section 4.5 as an advance waiver of rescission for a material  
19 breach of a lease, specifically, the *B.C. Richter Contracting Co.*  
and *Michel & Pfeffer* decisions.  
20

21 Flagship further argues that interpreting Section 4.5 as  
22 preventing rescission for a material breach is contrary to public  
23 policy reflected in California law. Flagship cites *Philippine*  
*Airlines, Inc. v. McDonnell Douglas Corp.*, 189 Cal.App.3d 234,  
24 237-238 (1987):  
25

26 [C]ontractual clauses seeking to limit  
liability will be strictly construed and any

1                   ambiguities resolved against the party  
2                   seeking to limit its liability for  
3                   negligence.

4                   'The language of an agreement in order to  
5                   exclude liability for negligence must be  
6                   "clear and explicit" and "free of ambiguity  
7                   or obscurity." ... The law generally looks  
8                   with disfavor on attempts to avoid liability  
9                   or to secure exemption from one's own  
10                  negligence ... The law requires exculpatory  
11                  clauses to be strictly construed against the  
12                  party relying on them ....

13                 Flagship also cites *Queen Villas Homeowners Ass'n v. TCB Property  
14                 Management*, 149 Cal.App.4th 1, 5 (2007) :

15                 Where a two-party contract purportedly  
16                 releases one side from liability to the other  
17                 (e.g., *Saenz v. Whitewater Voyages, Inc.*  
18                 (1991) 226 Cal.App.3d 758 ... [contract in  
19                 which plaintiff's decedent expressly assumed  
20                 the risk of white water rafting and relieved  
21                 defendant rafting company of liability]),  
22                 courts must look for clear, unambiguous and  
23                 explicit language not to hold the released  
24                 party liable. As the *Saenz* court nicely put  
25                 it: 'Everyone agrees that drafting a legally  
26                 valid release is no easy task. Courts have  
                       criticized and struck down releases if the  
                       language is oversimplified, if a key word is  
                       noted in the title but not the text, and if  
                       the release is too lengthy or too general, to  
                       name a few deficiencies ... However, we must  
                       remember that "[t]o be effective, a release  
                       need not achieve perfection ... It suffices  
                       that a release be clear, unambiguous, and  
                       explicit, and that it express an agreement  
                       not to hold the released party liable for  
                       negligence.'"'

27                 Flagship asserts that the law of indemnity provisions is similar.  
28                 See *Prince v. Pacific Gas and Electric Co.*, 45 Cal.4th 1151, 1158  
29                 (2009) :

30                 In the context of noninsurance indemnity  
31                 agreements, if a party seeks to be  
32                 indemnified for its own active negligence, or

1           regardless of the indemnitor's fault, the  
2           contractual language on the point 'must be  
3           particularly clear and explicit, and will be  
4           construed against the indemnitee.'

5           Flagship notes that California law bars the prior release of  
6           liability for gross negligence, *City of Santa Barbara v. Superior*  
7           *Court*, 41 Cal.4th 747, 758 (2007), or for negligent  
8           misrepresentations, *Blankenheim v. E.F. Hutton Co.*, 217  
9           Cal.App.3d 1463, 1473 (1990). Relying on this authority,  
10          Flagship contends:

11           As the foregoing reveals, California has a  
12           strong public policy of requiring exculpatory  
13           clauses, to the extent they are valid, to  
14           clearly and unequivocally advise the  
15           exculpating party of exactly what conduct of  
16           Defendants is subject to exculpation. As in  
17           the context of indemnity and releases,  
18           rescission can occur for a variety of  
19           circumstances. In this regard, Civil Code §  
20           1689 recognizes a range of circumstances  
21           under which a contract may be rescinded, from  
22           a consensual rescission to unilateral  
23           rescissions based on mistake, fraud or  
24           material failure of consideration ... The  
25           California Supreme Court has noted the range  
26           of circumstances upon which rescission could  
27           be based. (See *Runyan*, 2 Cal.3d 317). As  
28           such, there is a continuum of circumstances  
29           under which a contract may be rescinded from  
30           non-culpable and to culpable (i.e. a material  
31           breach) conduct.

32           Flagship argues that Section 4.5 "does not remotely meet the  
33           standard of a clear and unequivocal exculpatory provision"  
34           because "nothing in the language of Section 4.5 specifically  
35           mentions excusing the Defendants from a future material breach."  
36           Moreover, under this principle, given the prolixity of remedies  
37           court to be barred in Section 4.5, if Excel truly sought to bar  
38

1 the right of rescission, if could have said so.

2 Flagship's public policy analysis is inapposite. Section  
3 4.5 is not a release or an indemnity provision. Excel is arguing  
4 that Section 4.5 bars Flagship from the remedy of rescission even  
5 though Excel breached the Lease. No case is cited by Flagship  
6 that suggests that California Courts strike down such a provision  
7 or interpretation on the ground that it violates a fundamental  
8 public policy of California.

9       7. Unconscionable.

10 Flagship argues that interpreting Section 4.5 as a waiver of  
11 rescission would make Section 4.5 unconscionable as applied.

12 In the November 19, 2004 Memorandum Decision, the Court  
13 addressed Flagship's contention that Sections 4.5 and 22.25 are  
14 unconscionable as applied:

15       E. Unconscionability.

16 Plaintiffs claim that the Lease clauses are  
17 'unconscionable in light of the context of  
this transaction' and cannot be applied ...  
18 Defendants cite *Markborough California, Inc.*  
*v. Superior Court* for the proposition that a  
19 limitation of liability provision is  
enforceable ... That case also says that  
20 'although these provisions generally have  
been upheld as reasonable and valid,  
nonetheless, because they do in fact  
21 exculpate or insulate a party, at least to a  
certain extent, from liability for his or her  
own wrongful or negligent acts ... such  
provisions may be declared unenforceable if  
22 the provision is unconscionable or otherwise  
contrary to public policy.' *Markborough*  
*California, Inc. v. Superior Court*, 227  
23 Cal.App.3d 705, 714-715 (Cal.Ct.App.1991).  
24 This is an affirmative defense that was not  
pled or preserved as an issue for trial in  
25 the Pretrial Order.

1 (Doc. 353, 44:1-45:15). The Court then ruled that Flagship was  
2 not entitled to a jury trial on the issue of unconscionability,  
3 concluding that the case authority cited by Flagship did not  
4 establish a right to jury trial and:

5 Most importantly, the issue was not reserved  
6 for trial and an afterthought defense to  
7 enforcement of the contract cannot be  
8 countenanced. See *Canal Electric Co. v.*  
9 *Westinghouse Electric Co.*, 973 F.2d 988, 997-  
10 98 (1<sup>st</sup> Cir.1992) (raising unconscionability  
11 for the first time on appeal is untimely);  
12 *Oakwood Mobile Homes, Inc. v. Stevens*, 204  
13 F.Supp.2d 947, 951 (D.W.Va.2002) (raising  
unconscionability for the first time on the  
day of mandatory arbitration hearing is too  
late; defense waived). Cf *Beaver v. Figgie*  
*Intern. Corp.*, 849 F.2d 1472 (6<sup>th</sup> Cir.1988)  
(unpublished opinion) (on remand after grant  
of summary judgment reversed, issue of  
unconscionability now waived though it had  
never been previously raised).

14 (Doc. 353, 45:17-48:1). With regard to Flagship's claim of  
15 unconscionability as a matter of law, the Court ruled:

16 *Marin Storage & Trucking, Inc. v. Benco*  
17 *Contracting & Eng'g, Inc.*, 89 Cal.App.4th  
18 1042, 1052-1053 (Cal.Ct.App.2001) (citing *A&M*  
Produce Co. v. *FMC Corp.*, 135 Cal.App.3d 473,  
486-87 (Cal.Ct.App.1982) discusses  
unconscionability:

19 Unconscionability has both a  
20 procedural and a substantive  
21 element. The procedural element  
22 focuses [on] 'oppression' and  
'surprise.' '"Oppression" arises  
23 from an inequality of bargaining  
power which results in no real  
negotiation and "an absence of  
meaningful choice." "Surprise"  
24 involves the extent to which the  
supposedly agreed-upon terms are  
hidden in a prolix printed form  
25 drafted by the party seeking to  
enforce the disputed terms.' The

1 substantive element has to do with  
2 the effects of the contractual  
3 terms and whether they are  
4 unreasonable. Because a contract  
is largely an allocation of risks,  
a contractual provision is  
'substantively suspect if it  
reallocates the risks in an  
objectively unreasonable or  
unexpected manner.'

5  
6 To be unenforceable, a contract  
7 must be both procedurally and  
8 substantively unconscionable,  
although the greater the procedural  
unconscionability, the less  
9 unreasonable the risk allocation  
that will be tolerated.

10 Plaintiffs assert that Marvin Reiche (who  
11 negotiated the lease on behalf of Plaintiffs)  
had little bargaining power ... As evidence  
12 Plaintiffs point out that the Lease is based  
on a pre-existing Excel lease negotiated with  
another restaurant ... Even assuming this  
13 fact to be true, Plaintiffs have not  
demonstrated 'oppression,' which requires  
14 circumstances where the oppressed party was  
not in a position to negotiate and given no  
15 meaningful choice. Defendants assert that  
16 Plaintiffs had a choice since they were  
considering multiple sites for their proposed  
17 restaurant ... Plaintiffs were experienced  
and sophisticated restaurant operators. The  
Lease was negotiated and Plaintiffs insisted  
18 on the exclusive use clause. There is no  
evidence that the Briggsmore Plaza was the  
only site under consideration or that the  
Lease was offered on a take it or leave it  
basis. Defendants also point out that the  
Lease was actively negotiated over a period  
21 of months and Plaintiffs 'submitted extensive  
22 comments on the draft.' ....

23 Plaintiffs rely on *A&M Produce Co. v. FMC*  
24 Corp. to show that even contracts negotiated  
by experienced parties can be unconscionable  
where there is great imbalance of bargaining  
power ... The factual scenario of *A&M Produce*  
25 is significantly different from the one at  
hand since the plaintiff was not permitted to

1 negotiate the terms of the contract. *A&M*  
2 *Produce Co. v. FMC Corp.*, 135 Cal.App.3d 473,  
3 491 (Cal.Ct.App.1982). Plaintiffs did not  
4 adduce evidence that they were unable to  
negotiate the terms of the Lease. Plaintiffs  
did not show any other sites were unavailable  
or that they were without choice.

5 (Doc. 353, 48:3-49:21). As to the element of surprise as to  
6 Section 4.5, the Court ruled:

7 With respect to § 4.5, the Lease shows that  
8 the parties modified the provision, striking  
out the term 'or the Access Area' several  
9 times. These changes were ratified by  
initials 'MGR' (Marvin G. Reiche) in the  
margins ... Plaintiffs cannot claim that §  
10 4.5 escaped their notice.

11 (Doc. 353, 51:10-15).

12 Flagship contends that the Court's discussion of  
13 unconscionability in the November 19, 2004 Memorandum Decision  
14 was made only after finding that Flagship had not reserved the  
15 issue for trial with respect to the factual issues surrounding  
16 unconscionability of Section 4.5 and, therefore, the Court's  
17 "prior observations were dicta." Flagship refers to the Ninth  
18 Circuit's remand that the Court consider whether the Lease "in  
19 its entirety, allows for rescission and whether California law  
20 would give effect to the lease's limitations on remedies in these  
21 circumstances." Flagship asserts that the Ninth Circuit's  
22 mandate re-opens the issue of unconscionability in interpreting  
23 Section 4.5, citing *United States v. Kellington*, 217 F.3d 1084,  
24 1093 (9<sup>th</sup> Cir.2000) ("According to the rule of mandate, although  
25 lower courts are obliged to execute the terms of a mandate, they  
26 are free as to 'anything not foreclosed by the mandate.'").

1 Flagship further contends that the Ninth Circuit's mandate  
2 "suggests that this Court construed the pretrial order too  
3 narrowly in finding that Plaintiffs did not 'preserve' the issue  
4 of unconscionability for trial." Flagship asserts:

5 Specifically, the pretrial order asserted  
6 that Plaintiffs were seeking rescission and  
7 also that Plaintiffs sought declaratory  
8 relief with respect to the parties' rights  
9 and obligations under the Lease. (Doc. No.  
10 214, Pretrial Order at 14:10-15:21.) This  
11 statement of the relief sought, including a  
12 declaration of the rights of the parties,  
13 would seem sufficient to preserve the issue  
14 of unconscionability, with respect to  
15 Defendants' post-trial proffer of an  
interpretation of Section 4.5. If, as the  
court of appeal found, the statement of  
issues, facts and contentions in the pretrial  
order were sufficient to preserve Defendants'  
right to argue an interpretation of the Lease  
that they never presented before the jury's  
verdict was announced, it is also sufficient  
to preserve Plaintiffs' right to rebut such  
an argument, including the argument that  
Section 4.5 is unconscionable if interpreted  
as a waiver of rescission.

16 Although the Ninth Circuit's ruling in this case addressed  
17 the Court's invocation of judicial estoppel to bar Excel from  
18 contending that Section 4.5, Flagship's point that the Ninth  
19 Circuit's mandate allows consideration of the issue of  
20 unconscionability is well-taken because the Court is mandated to  
21 determine "whether the contract, in its entirety, allows for  
22 rescission and whether California law would give effect to the  
23 lease's limitations on remedies in these circumstances."

24 California Civil Code § 1670.5(a) provides:

25 If the court as a matter of law finds the  
26 contract or any clause of the contract to

1 have been unconscionable at the time it was  
2 made the court may refuse to enforce the  
3 contract, or it may enforce the remainder of  
4 the contract without the unconscionable  
clause, or it may so limit the application of  
any unconscionable clause as to avoid any  
unconscionable result.

5 Flagship argues that interpreting Section 4.5 as a waiver of  
6 rescission would render Section 4.5 unconscionable both  
7 substantively and procedurally, with the element of substantive  
8 unconscionability predominating over the element of procedural  
9 unconscionability.

10 As explained in *Gentry v. Superior Court*, 42 Cal.4th 443  
11 (2007), addressing the Court of Appeal's conclusion that a 30-day  
12 opt-out provision in an arbitration agreement was procedurally  
13 unconscionable:

14 " " To briefly recapitulate the principles of  
15 unconscionability, the doctrine has "both a  
16 'procedural' and a 'substantive' element,"  
the former focusing on "'oppression'" or  
"'surprise'" due to unequal bargaining power,  
the latter on "'overly harsh'" or "'one-  
17 sided'" results.' ... The procedural element  
of an unconscionable contract generally takes  
the form of a contract of adhesion, 'which,  
imposed and drafted by the party of superior  
18 bargaining strength, relegates to the  
subscribing party only the opportunity to  
adhere to the contract or reject it.'" ...  
Substantively unconscionable terms may take  
various forms, but may generally be described  
as unfairly one-sided."

22 As we have further explained: "The  
23 prevailing view is that [procedural and  
24 substantive unconscionability] must both be  
present in order for a court to exercise its  
25 discretion to refuse to enforce a contract or  
clause under the doctrine of  
unconscionability." ... But they need not be  
present in the same degree. "Essentially a

1           sliding scale is invoked which disregards the  
2 regularity of the procedural process of the  
3 contract formation, that creates the terms,  
4 in proportion to the greater harshness or  
unreasonableness of the substantive terms  
themselves." ... In other words, the more  
substantively oppressive the contract term,  
the less evidence of procedural  
5 unconscionability is required to come to the  
conclusion that the term is unenforceable,  
and vice versa.' ....

7           As the above suggests, a finding of  
8 procedural unconscionability does not mean  
that a contract will not be enforced, but  
rather that courts will scrutinize the  
9 substantive terms of the contract to ensure  
they are not manifestly unfair or one-sided  
10 ... [T]here are degrees of procedural  
unconscionability. Although certain terms in  
11 these contracts may be construed strictly,  
courts will not find these contracts  
12 substantively unconscionable, no matter how  
one-sided the terms appear to be. (See,  
13 e.g., *Nunes Turfgrass, Inc. v. Vaughn-Jacklin*  
*Seed Co.* (1988) 200 Cal.App.3d 1518, 1538-  
14 1539 ... [liability limitation negotiated by  
two commercial entities upheld].) Contracts  
15 of adhesion that involve surprise or other  
sharp practices lie on the other side of the  
16 spectrum. (See, e.g., *Ellis v. McKinnon*  
*Broadcasting Co.* (1993) 18 Cal.App.4th 1796,  
17 1804 ... [party told that signing contract  
was 'mere formality' to conceal oppressive  
forfeiture provision].) Ordinary contracts  
18 of adhesion, although they are indispensable  
facts of modern life that are generally  
19 enforced ... contain a degree of procedural  
unconscionability even without any notable  
surprises, and 'bear within them the clear  
20 danger of oppression and overreaching.' ....

22           Thus, a conclusion that a contract contains  
23 no element of procedural unconscionability is  
tantamount to saying that, no matter how one-  
24 sided the contract terms, a court will not  
disturb the contract because of its  
25 confidence that the contract was negotiated  
freely, that the party subject to a seemingly  
one-sided term is presumed to have obtained  
26 some advantage from conceding the term or

1           that, if one party negotiated poorly, it is  
2           not the court's place to rectify these kinds  
2           of errors or asymmetries.

3 42 Cal.4th at 468-470.

4           Flagship again relies primarily on *A&M Produce Co. v. FMC*  
5 *Corp.*, 135 Cal.App.3d 473 (1982). A&M brought suit against FMC  
6 from which it had bought a weight sizing machine for use in  
7 processing plaintiff's tomato crop, alleging breach of express  
8 and implied warranties. The trial court ruled that clauses in  
9 FMC's preprinted contract disclaiming all warranties and  
10 excluding consequential damages were unconscionable. The Court  
11 of Appeal affirmed. Flagship relies on the following statement  
12 from *A&M Produce Corp.*:

13           Another factor supporting the trial court's  
14 determination involves the avoidability of  
15 damages and relates directly to the  
16 allocation of risks which lie at the  
17 foundation of the contractual bargain. It  
18 has been suggested that '[r]isk shifting is  
19 socially expensive and should not be  
20 undertaken in the absence of a good reason.  
21 An even better reason is required when to so  
22 shift is contrary to a contract freely  
negotiated.' ... But as we noted previously,  
FMC was the only party reasonably able to  
prevent this loss by not selling A & M a  
machine inadequate to meet its expressed  
needs ... 'If there is a type of risk  
allocation that should be subjected to  
special scrutiny, it is probably the shifting  
to one party of a risk that only the other  
party can avoid.' ....

23 135 Cal.App.3d at 493.

24           Flagship argues that, according to Excel, Section 4.5 is not  
25 a reciprocal provision; it applies only to the tenant's  
26 obligations and does not bar any remedy by the landlord.

1 Flagship refers to Section 18.2(c) of the Lease:

2       18. EVENTS OF DEFAULT: REMEDIES

3       ...

4           18.2 Remedies.

5       ...

6           (c) If an Event of Default shall  
7 occur, then, in addition to any other rights  
8 or remedies available to Landlord at law or  
9 in equity, Landlord shall have the right to  
10 perform some or all of Tenant's Obligations  
11 which are then in default, without further  
notice to Tenant. In such event, any and all  
costs incurred by Landlord therefor  
(including, without limitation, reasonable  
attorney's fees and expenses) shall be  
payable by Tenant to Landlord upon demand.

12 Flagship argues that Excel's interpretation of the Lease is that  
13 Flagship waived its right to rescind in the event of Excel's  
14 material breach, but Excel maintained the right to all equitable  
15 remedies, including rescission, in the event of Flagship's  
16 breach. Citing *Money Store Investment Corp. v. Southern*  
17 *California Bank*, 98 Cal.App.4th 722, 728 (2002), Flagship argues  
18 that "such an imbalance in the parties' rights to rescind the  
19 agreement renders the Lease subject to attack for the lack of  
20 mutuality of obligation."

21 Flagship's reliance on the *Money Store Investment Corp.* to  
22 establish that Section 4.5 as construed by Excel is  
23 unconscionable, is misplaced. In *Money Store Investment Corp.*,  
24 the Court of Appeal stated:

25           The Bank asserts that the agreement was  
26 illusory because the Money Store's  
instructions 'reserved the right to withdraw

1 or amend these instructions at any time prior  
2 to the close of escrow.' The Bank is correct  
3 on its general point of law: 'Where a  
contract imposes no definite obligation on  
one party to perform, it lacks mutuality of  
obligation. It is elementary that where  
performance is optional with one of the  
parties no enforceable obligation exists....'  
5  
...

6 A corollary to that rule exists, however. An  
agreement that is otherwise illusory may be  
7 enforced where the promisor has rendered at  
least partial performance ... The Money Store  
8 performed. It provided the loan money  
necessary to complete the sale. Performance  
9 cured any illusory aspect of the agreement.

10 Here, Flagship does not argue that the Lease was illusory;  
11 rather, Flagship argues that Section 4.5, as construed by Excel,  
12 should not be enforced because of unconscionability.

13 Flagship asserts that Excel's interpretation of Section 4.5  
14 allocates the risk of Excel's failure to honor their promise of  
15 an exclusive buffet restaurant in the shopping center to  
16 Flagship. Flagship argues:

17 [Excel's] interpretation of Section 4.5 ...  
18 means that Flagship agreed to remain in a  
contract with Defendants regardless of  
19 Defendants' material breach; and that  
Flagship and the Reiches agreed to spend \$2  
million constructing a building on  
20 Defendants' property, with no ability to  
recoup the loss from Defendants in the event  
of Defendants' material breach of the Lease.  
In this regard, Defendants offered no  
21 evidence at trial that the parties intended  
Section 4.5 to operate in that fashion, or  
22 that the Reiches understood that Section 4.5  
meant that the Defendants could breach the  
23 exclusive [sic] immediately, and Flagship  
would be stuck with the Lease. This result,  
like the preclusion of consequential damages  
24 in *A&M Produce* is substantively  
unconscionable and shocking to the  
25  
26

1                   conscience.

2                   Flagship fails to demonstrate procedural unconscionability.  
3 As concluded in the November 19, 2004 Memorandum Decision, the  
4 Lease was negotiated on both sides by sophisticated, experienced  
5 parties. That Flagship did not know or understand that Excel  
6 would attempt to construe Section 4.5 to preclude rescission of  
7 the lease by Flagship because of Excel's breach of Section 6.3's  
8 exclusive use provision does not establish procedural  
9 unconscionability.

10                  8. Jury's Finding of Material Breach Defeats  
11 Independent Covenant.

12                  Flagship argues that the jury's finding of material breach  
13 defeats any contention that the exclusive use provision was an  
14 independent covenant, referring to the statement in Section 4.5  
15 that "[t]he obligations of Tenant in this Lease shall be separate  
16 and independent covenants and agreements." Flagship contends  
17 that, if Excel believed that Section 4.5 made Excel's obligation  
18 to honor the exclusive use provision an independent covenant,  
19 thereby making the breach of the exclusive use provision not  
20 material, Excel should have presented this contention to the  
21 jury. Flagship asserts: "Because Defendants did not do so, and  
22 the jury decided the question of materiality, they cannot now ask  
23 the court to decide this question."

24                  Flagship cites *Gaia Technologies, Inc. v. Recycled Products,*  
25 *Corp.*, 175 F.3d 365 (5<sup>th</sup> Cir.1999). In *Gaia*, the alleged owner  
26 of patents and trademarks brought an action against corporate and

1 individual defendants for infringement under federal law, and for  
2 unfair competition, tortious interference with prospective  
3 contractual relations, and misappropriation of trade secrets  
4 under state law. After the alleged owner obtained judgment  
5 against defendants, the Federal Circuit reversed as to the  
6 infringement claims and remanded, allowing the District Court to  
7 decide whether to exercise supplemental jurisdiction over the  
8 state law claims. On remand, the District Court entered judgment  
9 for the alleged owner on the state law claims and the individual  
10 defendants appealed to the Fifth Circuit. The Fifth Circuit held  
11 that the District Court erred in relying on Rule 49(a), Federal  
12 Rules of Civil Procedure, to make findings contrary to the jury's  
13 verdict:

14 Nothing in the text of Rule 49(a) authorizes  
15 a district court to reform a jury's decision  
16 on issues submitted to the jury. Rule 49(a)  
17 allows the district court to make its own  
18 findings only as to issues not submitted to  
the jury ... Furthermore, Rule 49(a) does not  
19 permit a district court to make findings  
contrary to the jury verdict. See *Askanase*,  
130 F.3d at 670 ('Appellant correctly states  
that a Rule 49(a) finding cannot be  
inconsistent with the jury verdict.'); see  
also *Floyd v. Laws*, 929 F.2d 1390, 1397 (9<sup>th</sup>  
Cir.1991) (holding that 'under Rule 49(a), the  
trial court simply cannot choose to ignore a  
legitimate finding that is part of the  
special verdict'). Here, the district court  
submitted the elements of Gaia's state law  
claims to the jury, and the jury found that  
Gaia failed to prove any of the elements as  
to the individual defendants. Thus Rule  
49(a) does not authorize the district court  
to reform the jury's state law findings in  
order to hold the individual defendant's  
liable for Gaia's state law causes of action.

1 *Id.* at 370-371.

2 Flagship notes that, although Flagship argued that the  
3 verdict was a special verdict, the Court ruled that the verdict  
4 was a general verdict. (Doc. 353, November 19, 2004 Memorandum  
5 Decision, 29:6-7). Flagship contends that the "rule articulated  
6 in *Gaia*" is not tied to any particular form of verdict:

7 Preliminarily, the individual defendants  
8 contend that we should treat the jury verdict  
9 as a general verdict accompanied by  
10 interrogatories, governed by Rule 49(b), as  
11 opposed to a special verdict, governed by  
12 Rule 49(a) ... According to the defendants,  
13 Rule 49(b) affords greater deference to a  
14 jury's finding than Rule 49(a). We need not  
15 address this contention, however, because we  
16 conclude that not even Rule 49(a) authorizes  
17 the district court's modification of the jury  
18 verdict. *Gaia* does not contend that Rule  
19 49(b) provides an alternative ground for  
20 upholding the district court's reformation.

21 *Gaia, supra*, 175 F.3d at 370 n.5. Because, Flagship argues, the  
22 type of verdict does not affect the "validity of this rule," and  
23 "because the jury decided that the exclusive use provision, and  
24 Defendants' breach thereof was material, Defendants cannot now  
25 ask the court to make a ruling contrary to the jury's verdict."

26 Excel responds that the jury's verdict is irrelevant to  
27 interpretation of the Ground Lease, an issue of law for the  
28 Court. However, as ruled *supra*, Excel's construction of Section  
29 4.5 is without merit.

30 Excel further asserts that, in an action at law for breach  
31 of contract, a material breach generally entitles the non-  
32 breaching party to cancel a contract prospectively and recover

1 damages, but does not, as a matter of course justify rescission.  
2 Excel contends that Flagship cites no authority allowing  
3 rescission for breach of an independent covenant:

4 They simply assert that the jury's finding of  
5 a 'material breach' in the breach of contract  
6 action trumps the Ground Lease and converts  
7 its independent covenants into conditions  
8 precedent. This is unsustainable as a matter  
9 of the law of independent covenants and,  
therefore, the finding of material breach is  
irrelevant to the issues now before the  
Court.

10 Excel argues that, if the jury had found the exclusive use  
11 provision to be a dependent covenant, such a verdict would have  
12 been vacated by the Court under Rule 50, Federal Rules of Civil  
13 Procedure, as not supported by the evidence. For the reasons  
14 stated *supra*, Excel's contention is baseless, if not vexatious.  
15 A jury does not make a legal finding whether a covenant is  
dependent.

16 Excel cites *Barerra v. State Farm Mut. Auto. Ins. Co.*, 71  
17 Cal.2d 659 (1969). In *Barrera*, the plaintiff sued State Farm to  
18 compel payment of a judgment against State Farm's insureds, the  
19 Alves, for their negligent driving that injured the plaintiff.  
20 Plaintiff alleged the enforceability at the time of the accident  
21 of State Farm's liability policy. State Farm denied the validity  
22 of the policy, and cross-claimed seeking a declaration that the  
23 policy was void *ab initio* because it was issued in reliance on a  
24 material misrepresentation by the Alves. Plaintiff contended  
25 that State Farm was estopped to rescind the policy six months  
after the accident because State Farm led the Alves to believe

1 that he was insured and because State Farm negligently failed to  
2 discover within a reasonable time the misrepresentation in the  
3 application tendered more than a year prior to the accident. The  
4 trial court found that State Farm issued the policy in reliance  
5 on a material misrepresentation, that rescission was therefore  
6 justified, and that State Farm acted promptly upon discovery of  
7 the misrepresentation, and found for State Farm. Plaintiff moved  
8 for a new trial on the ground that the public policy expressed in  
9 California's Financial Responsibility Law impelled a finding of  
10 laches by State Farm in its belated discovery of the  
11 misrepresentation and that its failure to act promptly worked to  
12 the detriment of an innocent member of the public, who should  
13 therefore recover against State Farm. The trial court denied the  
14 motion for new trial. On appeal, the Supreme Court reversed for  
15 a new trial, ruling that an automobile liability insurer must  
16 undertake a reasonable investigation of the insured's  
17 insurability within a reasonable period of time from the  
18 acceptance of the application and issuance of the policy; that  
19 this duty inures directly to the benefit of third persons injured  
20 by the insured; that the injured party, who has obtained an  
21 unsatisfied judgment against the insured, may proceed against the  
22 insurer; and that the insurer cannot then successfully defend  
23 upon the ground of its own failure reasonably to investigate the  
24 application. 71 Cal.2d at 663. The Supreme Court noted:

25 In addition to arguing that State Farm was  
26 estopped to rescind the policy because of  
negligent failure to discover the

1 misrepresentation within a reasonable time,  
2 plaintiff also argued that section 651 of the  
3 Insurance Code applied to rescission as well  
4 as to prospective cancellation of automobile  
5 insurance policies, and that therefore the  
6 attempted rescission did not take effect  
until 10 days after notice of rescission was  
sent to Mr. Alves. If termination of the  
policy did not occur until after notice, the  
policy remained in effect at the time of the  
accident.

7 Plaintiff's contention regarding section 651  
8 runs counter to the statutory scheme for  
termination of insurance contracts and blurs  
the clear statutory distinction between  
9 'rescission' (retroactive termination) and  
'cancellation' (prospective termination) of  
insurance policies. Section 651 provides:  
10 'Notwithstanding any other provision of this  
code, no cancellation by an insurer of an  
auto liability insurance policy shall be  
11 effective prior to the mailing or delivery to  
the named insured at the address shown in the  
12 policy, of a written notice of cancellation  
stating when, not less than ten (10) days  
13 after the date of such mailing or delivery,  
the date the cancellation shall become  
14 effective.'

15  
16 The Legislature added section 651 in 1957 ...  
17 In 1957, the Insurance Code did not contain a  
separate chapter on 'Cancellation' ....

18 The statutory scheme reflects a deliberate  
distinction between 'rescission' and  
19 'cancellation.' Sections 331, 338, and 359,  
which prescribe the grounds for rescission,  
20 all involve false statements or material  
omissions in the procurement of the policy.  
Section 660 ..., on the other hand, provided:  
21 'The commissioner, by regulation, shall  
prescribe the grounds upon which an insurer  
may cancel a policy of automobile insurance.  
No insurer shall cancel a policy of  
22 automobile insurance except upon such ground  
or grounds as have been prescribed by the  
commissioner.' ....

23  
24 Unless we say that automobile liability  
25 insurance policies cannot be rescinded at all

1 and that section 660 completely abrogated the  
2 rescission section for automobile liability  
3 insurance, we must hold that section 651,  
4 which specifically refers to 'cancellation,'  
5 does not control the procedure for  
6 'rescission' of automobile liability  
7 insurance. Instead, the general section  
8 governing rescission of insurance policies,  
9 section 650, applies. Section 650 provides:  
10 'Whenever a right to rescind a contract of  
11 insurance is given to the insurer by any  
12 provision of this part such right may be  
13 exercised at any time previous to the  
14 commencement of an action on the contract.'  
15 The issue, then, turns on the validity of  
16 plaintiff's contention that the public policy  
17 of this state requires that an automobile  
18 liability insurer reasonably investigate  
19 within a reasonable time after issuance of  
20 the policy or otherwise be estopped to  
21 rescind the policy, at least in an action by  
22 an injured person who has obtained a judgment  
23 from the insured.

24 71 Cal.2d at 663 n.3.

25 Excel also cites *Mamula v. McCulloch*, 275 Cal.App.2d 184,  
26 196-197 (1969):

27 Plaintiff urges that the court erred in  
28 failing to make findings upon the issue as to  
29 whether or not she was entitled to recover on  
30 the theory of unjust enrichment.

31 The trial court found that the oral agreement  
32 of July 1, 1963, was for the abandonment and  
33 cancellation of the oral purchase and sale  
34 agreement involving the hospital property and  
35 that it was supported by a valuable  
36 consideration. As heretofore pointed out,  
37 such oral agreement made a complete  
38 disposition of the rights of the respective  
39 parties under the oral purchase and sale  
40 agreement. Such rights having been  
41 completely settled by the oral contract of  
42 abandonment, there was no basis for the  
43 application of the rule of unjust enrichment.

44 'To "cancel" a contract means to abrogate so  
45 much of it as remains unperformed. It

1           differs from "rescission," which means to  
2           restore the parties to their former position.  
3           The one refers to the state of things at the  
4           time of cancellation; the other to the state  
5           of things existing when the contract was  
6           made.' ... Here, the oral agreement of  
7           cancellation did away with the oral agreement  
8           of purchase and sale upon the terms and  
9           conditions and with the consequences  
10          mentioned in the agreement of cancellation  
11          ... In this state of the record, a specific  
12          finding on whether plaintiff was or was not  
13          entitled to recover on the theory of unjust  
14          enrichment would be redundant.

15         Excel cites *Fireman's Fund American Ins. Co. v. Escobedo*, 80  
16         Cal.App.3d 610 (1978), which involved an action by the insurance  
17         company of one motorist against the insurance company of the  
18         second motorist and the motorists. The trial court determined  
19         that defendant insurer's rescission of its insureds' assigned  
20         risk automobile policy was effective as against its insureds, but  
21         ineffective as against the owners and drivers of the other  
22         vehicle and plaintiff, their insurer. On appeal, the Court of  
23         Appeals addressed the argument that once a risk has been assigned  
24         under the California Automobile Assigned Risk Plan (CAARP) and  
25         the designated insurer has ratified the coverage, 10 California  
26         Administrative Code § 2470, specifies the only method open to an  
            insurer to relieve itself of an assigned risk which was accepted:

27         Section 331 of the Insurance Code provides:  
28         'Concealment, whether intentional or  
29         unintentional, entitles the injured party to  
30         rescind insurance.' Concealment is defined  
31         as 'Neglect to communicate that which a party  
32         knows, and ought to communicate ....' ... In  
33         addition to concealment as a ground for  
34         rescission, section 359 of the Insurance Code  
35         provides that a contract of insurance may be  
36         rescinded on the ground of material

1 misrepresentation: 'If a representation is  
2 false in a material point, whether  
3 affirmative or promissory, the injured party  
is entitled to rescind the contract from the  
time the representation becomes false.' ....

4 The California Assigned Risk Plan was enacted  
5 to provide liability insurance coverage for  
applicants who are *in good faith* entitled to  
but unable to procure such insurance through  
6 ordinary methods ... Nothing in the  
7 authorizing legislation suggests that the  
laws applying to insurance policies in  
general are not applicable to the assigned  
8 risk plan. The regulations promulgated by  
CAARP deal only with cancellation and not  
rescission. Cancellation and rescission are  
not synonymous. One is prospective, while  
the other is retroactive ... Appellant  
Employer's Casualty is correct in its  
contention that the statutory remedy of  
rescission is applicable to assigned risk  
policies.

13 80 Cal.App.3d at 619.

14 Excel also cites *Welles v. Turner Entertainment Co.*, *supra*,  
15 503 F.3d 728.<sup>4</sup> In *Welles*, the plaintiff argued that the Exit  
16 Agreement, which "cancelled and terminated" the Production  
17 Agreement, returned the *Citizen Kane* copyright to Mercury. The  
18 Ninth Circuit ruled:

19 [T]he Exit Agreement stated that it was 'the  
20 mutual desire of the parties to terminate and  
cancel' their prior agreements. Beatrice  
21 Welles argues that this language rescinded  
the parties' prior agreements and thus  
22 returned any right Orson Welles and Mercury  
had in the *Citizen Kane* motion picture to  
them. However, under California law, it  
23 seems that 'terminate' and 'cancel' mean  
something different from 'rescind':

25 <sup>4</sup>Excel cited *Welles* as *Welles v. Turner Entertainment Co.*, 488  
F.3d 1178 (9<sup>th</sup> Cir.2007). However, the opinion was amended and  
26 superseded on denial of rehearing.

1           The words 'terminate,' 'revoke' and  
2           cancel,' ... all have the same  
3           meaning, namely, the abrogation of  
4           so much of the contract as might  
5           remain executory at the time notice  
6           is given, and must be sharply  
7           distinguished from the word  
8           'rescind,' ... which conveys a  
9           retroactive effect, meaning to  
10          restore the parties to their former  
11          position.

12           *Grant v. Aerodraulics Co.*, 91 Cal.App.2d 68  
13           ... (1949). Thus, under California law, the  
14          Exit Agreement prospectively terminated and  
15          cancelled Orson Welle's right to royalties,  
16          but did not retroactively rescind RKO's  
17          copyright in the *Citizen Kane* motion picture  
18          unless RKO's copyright remained executory at  
19          the time of the Exit Agreement.

20          503 F.3d at 738.

21          Excel asserts that the jury was not instructed on rescission  
22          or failure of consideration, but was instructed only on  
23          prospective cancellation in connection with Flagship's breach of  
24          contract claim. This, of course, was a result of the parties'  
25          express agreement that the issue of rescission was to be  
26          determined after the jury's verdict. Excel refers to the Court's  
27          statement to the jury on December 2, 2003 (Exh. E to Excel's  
28          response to Flagship's motion regarding interpretation of Section  
29          4.5):

30           defendant was - and I'm using the word Excel  
31           Realty Partners, that's one of the defendants  
32           - was canceled.

33           A party to a contract may cancel the contract  
34          if, for any reason, the party does not  
35          receive the material performance that was  
36          promised by the other party or if an  
37          important part of the performance that was  
38          promised was not provided.

1           The term 'material,' as used in the  
2         instructions, means important or serious.  
3         You must decide whether plaintiff failed to  
4         receive any material performance defendant  
5         promised to provide. Performance is material  
6         if it is important to a contract and if it is  
7         likely to cause a reasonable person not to  
8         have entered into the contract if such  
9         performance was not provided.

10       Thus, Excel contends, the jury was never instructed on rescission  
11      and never asked to determine whether there was a failure of  
12      consideration (or whether the breach was so material that it  
13      would constitute a failure of consideration). Based on *Welles*,  
14      Excel contends:

15       [T]he jury verdict of material breach in no  
16      way constituted a finding of a failure of  
17      consideration or of a right to rescission.  
18      And, the jury's verdict cannot overrule a  
19      fundamental principle of contract, that  
20      breach of an independent covenant does not  
21      justify rescission.

22       Flagship replies that the cases upon which Excel relies in  
23      distinguishing between "cancel" and "rescind" concern  
24      interpretation of insurance policy language under very specific  
25      provisions of the California Insurance Code or the construction  
26      of a second agreement that purported to "cancel" a prior  
agreement. This is true. The insurance contract cases are  
inapplicable. Flagship cites *Pico Citizens Bank v. Tafco, Inc.*,  
201 Cal.App.2d 131 (1962).

27       In *Pico Citizens Bank*, Moos and Tafco entered into a written  
28      contract by which Moos agreed to manufacture and Tafco agreed to  
29      sell knife and scissor sharpeners. In a letter signed by Tafco's  
30      president, various oral agreements theretofore reached were

1 confirmed; among other things, the agreement provided that title  
2 to the sharpeners would remain in Moos until they were sold by  
3 Tafco to third parties. Another clause of the contract provided:  
4 "In the event it [the contract] is cancelled by either party, the  
5 above arrangement will remain in effect until you [seller] have  
6 been paid for the merchandise delivered and the dies and other  
7 equipment of ours returned to us. Neither party shall terminate  
8 any part of this agreement without giving the party ninety (90)  
9 days written notice in advance." The appellate court held:

10 Taking up the first of Tafco's major points  
11 on appeal, it is contended that neither the  
letter of May 10, 1955, nor the notice of  
rescission received by Tafco on June 24,  
1955, served to cancel the contract within  
the meaning of the subject agreement.  
13 Emphasized by Tafco is the claim that the  
word 'cancel' is not found in either  
14 document. Thus, the May 10 letter simply  
demanded an accounting and payment in full of  
15 the outstanding balance, while the June  
notice and demand made use of the word  
16 'rescission' in its heading. There is a  
distinction, of course, between the terms  
17 'cancel' and 'rescind' - accordingly, it has  
been observed that 'an important problem of  
construction is presented by notices or  
agreements which purport to terminate the  
19 contract.' (Witkin, Summary of Cal. Law (7<sup>th</sup>  
ed. 1960) 324). Cited in the work just  
quoted is *Winter v. Kitto*, 100 Cal.App. 302  
20 . . . , wherein expressions of 'cancellation' or  
'rescission' were not construed as the  
renunciation of any claim for damages for  
22 prior breach unless such intention clearly  
appears. The factual question is a close  
one; but two trials have resulted in findings  
24 that either or both of the documents just  
mentioned effected a cancellation pursuant to  
the terms of the agreement. 'The question of  
25 whether a contract has been cancelled,  
rescinded or abandoned is a mixed question of  
law and fact . . . which is addressed to the

1           trial court ... and the finding of the trial  
2           court will be upheld if it is supported by  
3           substantial evidence.' ....

4 Relying on this statement from *Pico Citizens Bank* and their  
5 asserted distinction of the cases relied upon by Excel, Flagship  
6 asserts:

7           As such, the difference between cancellation  
8           and rescission is material to construing a  
9           second agreement or writing and whether it  
10          purports to cancel the remainder of a  
11          contract that is executory, or whether it  
12          seeks to rescind the contract ... Here, Excel  
13          does not raise any issue that Flagship's  
14          notice of rescission, which was presented to  
15          the jury, sought anything other than  
16          rescission. Overall, Defendants do not  
17          explain how these cases advance their  
18          proffered interpretation of the Lease.

19          What can be said about the jury's verdict is that it  
20          determined there was a breach of contract and that the breach was  
21          material, giving rise to Flagship's election of remedies.

22          9. Equitable Estoppel.

23          Although conceding that judicial estoppel may not apply to  
24          the facts, Flagship asserts that the Court did not decide whether  
25          equitable estoppel applied. Flagship refers to the September 30  
26          Memorandum Decision, (Doc. 362, 18:23-19:):

27          Defendant also argues that the court erred in  
28          holding that equitable estoppel barred  
29          Defendant from asserting § 4.5 as a defense.  
30          While it is true that the court cited  
31          elements of equitable estoppel in the  
32          estoppel section of its decision, it is not  
33          the case that the court actually held that  
34          equitable estoppel applied. A careful  
35          reading of the estoppel discussion reveals  
36          that the court's reasoning followed the law  
37          of judicial estoppel. At the end of the  
38          section, the court stated that '[b]y staying

1 silent on § 4.5 until the 9<sup>th</sup> day of trial  
2 and leading the court and Plaintiffs to  
3 believe that rescission was being actively  
4 litigated, Defendants are estopped from  
5 raising § 4.5 as a bar to a rescission  
6 remedy.' (Doc. 353, November 2004 Order 53)  
7 The court's discussion of the equitable  
8 estoppel standard and the absence of specific  
reference to judicial estoppel, even if  
ambiguous, does not prevent the application  
of judicial estoppel. This holding requiring  
Defendant to be bound by its conduct  
throughout the litigation is not clearly  
erroneous. Defendant was properly estopped  
from asserting § 4.5 as a bar to rescission.

9 Four elements must ordinarily be proved to establish an  
10 equitable estoppel: (1) the party to be estopped must know the  
11 facts; (2) he must intend that his conduct shall be acted upon,  
12 or must so act that the party asserting the estoppel had the  
13 right to believe that it was so intended; (3) the party asserting  
14 the estoppel must be ignorant of the true state of facts; and (4)  
15 he must rely upon the conduct to his injury. *Salgado-Diaz v.*  
16 *Ashcroft*, 395 F.3d 1158, 1166 (9<sup>th</sup> Cir.2005); *Hampton v.*  
17 *Paramount Pictures Corp.*, 270 F.3d 100, 104 (9<sup>th</sup> Cir.1960).

18 Flagship argues that these elements are satisfied:

19 Defendants allowed this case to proceed from  
the complaint through discovery, through  
trial without ever suggesting that  
20 Plaintiffs' were barred from their clearly  
pled claim for rescission. Defendants acted  
such that Plaintiffs had the right to believe  
21 the Lease did not prevent rescission, and  
that Defendants would assert this position.  
Plaintiffs had no idea Defendants would claim  
22 a provision listed in the Lease paragraph  
concerning rent and not expressly mentioning  
23 the word rescission barred the remedy of  
rescission. Plaintiffs reliance on  
24 Defendants' position is only strengthened by  
25 Defendants complete failure to raise the  
26

1 issue in their answers, discovery responses,  
2 summary judgment proceedings, in motions in  
3 limine, pretrial statements, or pretrial  
conferences. As this Court has recognized,  
4 Plaintiffs relied on Defendants' failure to  
assert Section 4.5 as a bar to rescission,  
and therefore were prejudiced by not having  
the opportunity to conduct discovery as to  
5 the 'commercial setting, purpose, and effect'  
of Section 4.5. (Doc. No. 362 at 18:10-22).  
6

7 In the September 30 Memorandum Decision, the Court, in its  
8 discussion of application of judicial estoppel, ruled:

9 Third, Defendant would obtain an unfair  
10 advantage if it is allowed to assert § 4.5 as  
11 a bar to rescission at such a late stage in  
the litigation. Discovery was not conducted  
as to § 4.5. Plaintiffs did not know the  
12 section would be invoked as a defense by any  
dispositive motion or the Pretrial Order.  
The contract damages awarded by the jury that  
Defendant would have to pay amount to  
approximately \$1.5 million; the damages that  
13 Defendant could potentially pay if rescission  
is granted are substantially more, up to the  
14 [sic] approximately \$3.9 million. Finally,  
estoppel in this situation serves the overall  
15 policy goal of judicial estoppel to 'protect  
against a litigant playing fast and loose  
16 with the courts.' ....  
17

(Doc. No. 362 at 18:10-22).

18 Excel responds that Flagship's argument concerning  
19 application of equitable estoppel is "utterly spurious." Excel  
20 refers to the November 19, 2004 Memorandum Decision, (Doc. 353),  
21 where the Court discussed whether Excel waived application of  
22 Section 4.5 as a contractual limitation on the recovery available  
23 to Flagship. (Doc. 353, 37:12-54:5). Specifically, Excel  
24 refers to the following conclusion in the November 19, 2004  
25 Memorandum Decision:  
26

With respect to contractual limitations on damages in a contract dispute, the defense is contained in the cause of action itself.

Both sides had full access to the Lease (38 pages long) and are presumed to have examined it carefully. There is no danger of unfair surprise by assertion of this defense.

(Doc. 353, 41:22-26). Excel contends that Flagship was not ignorant of the true facts:

Excel is unaware of any basis or any judicial precedent applying equitable estoppel to a party's assertion of its rights under a written contract, the provisions of which were specifically negotiated and executed by the parties and Plaintiffs have cited no such authority. This is not a case of a hidden unknown fact being secreted by one party to disadvantage another.

Flagship replies that Excel mischaracterizes Flagship's asserted basis for equitable estoppel:

Defendants never asserted their interpretation that Section 4.5 bars rescission until over two years after Plaintiff's notice of rescission, and until after a 9-day trial litigating the very remedy they claim Section 4.5 bars. (See Pltfs' P&A at 19-23.) If Defendants believed Section 4.5 meant what they now claim it does, it was incumbent on them to assert the bar to rescission upon receipt of Plaintiffs' notice of rescission, in their answer, discovery responses, summary judgment motions, trial brief, or motions in limine. Instead, Defendants allowed the entire case to proceed, even acquiescing that rescission was an available remedy at the pretrial conference (See Pltfs' ER, Ex. J at 18), without mentioning that any provision of the Lease, in their view, barred rescission. A clearer case for equitable estoppel could not be made.

Flagship's reference is to the hearing on motions in limine conducted on October 31, 2003, where the Court inquired "whether

1 anybody wants the jury to be making any findings on the  
2 rescission." Mr. Fairbrook indicated that Flagship wished  
3 issues of contested fact as to equitable matters submitted to the  
4 jury. Mr. Carroll stated:

5 The defense perspective is that there's two  
6 issues really. One is we believe the  
7 plaintiffs have taken the position that  
8 mistake is no longer an issue in this case,  
both in conjunction with the pretrial  
statement and in the opposition of motions  
for summary judgment.

9 The only grounds for rescission left in the  
10 case at this point is a failure for  
consideration. That's the position we take,  
11 that's what's been represented, that's the  
position we understood to be the case at this  
juncture.

12 (Doc. 502, Exh. J).

13 There is no question that Excel failed to assert that  
14 Section 4.5 precluded the remedy of rescission until after the  
15 trial in this action and that Excel's delay in asserting its  
16 interpretation of Section 4.5 caused undue attorney and judicial  
17 time in post-trial proceedings involving Flagship's election of  
18 the rescission remedy. Excel's contention that Flagship was  
19 always aware that Section 4.5 barred rescission by Flagship of  
20 the lease because of Excel's breach of the exclusive use  
provision is not supported by the record in this action and  
21 Excel's belated assertion of its position precluded Flagship from  
22 conducting discovery concerning Excel's interpretation of Section  
23 4.5 or seeking summary judgment as to the construction of Section  
24 4.5 in the context of extrinsic evidence. The position was also  
25

1 unknown to the Court. The Section 4.5 bar theory was not  
2 asserted in pleadings, it was not specifically disclosed in the  
3 Pretrial Order, nor was it the subject of any discussion in a  
4 trial brief or in jury instruction input.

5           10. Arguments Raised by Excel in Opposition to  
6 Flagship's Motion.

7           In opposing Flagship's motion, Excel asserts that rescission  
8 is barred because Plaintiffs, by their conduct, affirmed the  
9 Ground Lease after they asserted that Excel breached it, and  
10 because Plaintiffs failed to proffer the written consent of the  
11 Money Store to extinguish the estate created by the Ground Lease  
12 as required by Section 22.4. It is in connection with this  
13 latter contention that Excel's motion to strike and/or for leave  
14 to file a sur-reply brief is directed. In addition, Flagship  
15 contends that Excel attacks the jury instructions with respect to  
16 rescission.

17           a. Outside the Ninth Circuit's Mandate.

18           Flagship argues that these contentions are outside the  
19 mandate of the Ninth Circuit, e.g., to "determine in the first  
20 instance whether the contract, in its entirety, allows for  
21 rescission and whether California law would give effect to the  
22 lease's limitations on remedies in these circumstances."

23           As explained in *Kearns v. Field*, 453 F.2d 349, 350 (9<sup>th</sup>  
24 Cir.1972):

25           The mandate is controlling as to all matters  
26 within its compass ...; however, any issue  
not expressly or impliedly disposed of on

1 appeal may be considered by the trial court  
2 on remand.

3 Flagship's contention raises the question whether the Ninth  
4 Circuit's remand is a "limited remand" or a "general remand."  
5 The term "limited remand" describes a remand to the district  
6 court for proceedings prior to the Ninth Circuit's consideration  
7 of the merits of an appeal. See *United States v. Washington*, 172  
8 F.3d 1116, 1118 (9<sup>th</sup> Cir.1999), citing *Mirchandani v. United*  
9 *States*, 836 F.2d 1223, 1225 (9<sup>th</sup> Cir.1988). Once an appeal has  
10 been decided on the merits, the mandate is issued; if the case is  
11 remanded for further proceedings, the trial court must proceed in  
12 accordance with the mandate and the law of the case as  
13 established on appeal. *Id.*, citing *Stevens v. F/V Bonnie Doon*,  
14 731 F.2d 1433, 1435 (9<sup>th</sup> Cir.1984). The mandate "'is controlling  
15 as to all matters within its compass, but leaves the district  
16 court any issue not expressly or impliedly disposed of on  
17 appeal.'" *Id.*

18 In contending that the issues raised by Excel are outside  
19 the mandate, Flagship asserts that it is clear that the Ninth  
20 Circuit specifically directed the Court to decide whether Section  
21 4.5 of the Lease, as construed in its entirety, is a bar to  
22 rescission. Flagship argues:

23 While the court expressly left open the  
24 question of rescission damages, the mandate  
25 did not set the case at large. Importantly,  
the court of appeal did not disturb the  
jury's verdict. Most significantly in this  
regard, Excel on appeal attacked the jury  
verdict in two respects: arguing that the  
26 jury was not instructed on rescission, and

1           that the evidence was insufficient to support  
2           a finding of material breach, necessary to  
3           support rescission ... In issuing a limited  
4           mandate that the district court must decide  
5           whether Section 4.5 of the Lease bars the  
6           remedy of rescission, the court of appeal  
7           impliedly rejected these arguments. In this  
8           regard, it would make little sense to remand  
9           the case to the district court to determine  
10          if rescission could be elected by Plaintiffs  
11          if the jury's finding of a material breach  
12          was not supported by the evidence as Excel  
13          contended on appeal. Accordingly, implied  
14          within the court of appeal's mandate is a  
15          rejection of Defendants' claims of  
16          instructional error and sufficiency of the  
17          evidence.

18          Flagship's contention is without merit. The Ninth Circuit's  
19          remand is broad enough to permit the Court to consider whether  
20          rescission, if permissible under the terms of the lease, is  
21          nonetheless barred under California law because of Flagship's  
22          conduct after notice of rescission was given.

23                 b. Rescission Barred by Flagship's Conduct.

24          Excel argues that rescission is barred because Flagship  
25          affirmed the Lease after asserting that Excel had breached it.

26          Excel cites 1 Witkin, *Summary of California Law, Contracts*,  
27          § 886: "The injured party may lose his right to rescind by ...  
28          conduct (such as retention of benefits) indicating an election to  
29          affirm the contract." Excel further cites *Neet v. Holmes*, 25  
30          Cal.2d 447, 457-458 (1944):

31                 The general rule, with certain exceptions not  
32                 applicable to the facts involved in the case,  
33                 is that the offer to restore what has been  
34                 received under the contract is a condition  
35                 precedent to maintaining an action founded on  
36                 the assumption that rescission has been  
37                 accomplished by the act of the party ... The

right to rescind may be waived ... It is waived by recognition of the existence of the contract after the right to rescind was created ... Waiver of a right to rescind will be presumed against a party who, having full knowledge of the circumstances which would warrant him in rescinding, nevertheless accepts and retains benefits accruing to him under the contract ... It has been said that citation of authorities is unnecessary in support of the doctrine well established in this state that an affirmation of the contract at a time subsequent to the discovery of the falsity of the representations inducing its execution forecloses the exercise of the right of rescission.

Excel argues that Flagship affirmed the Lease by entering into two Forebearance Agreements with The Money Store in October 2001 and October 2002, respectively. (Excel's Response, Exhs. B and C). The Forebearance Agreements each provide that Flagship "shall continue to make monthly lease payments to Excel Realty Partners." The Forebearance Agreements provide:

It is expressly understood that the failure to make payments or meet any term as referenced in this Agreement will constitute a default of the Forebearance Agreement and [TMS] will then be free to exercise any and all rights consistent with the Stockton Loan and the Modesto Loan agreements.

Excel asserts that Flagship voluntarily entered into the Forebearance Agreements with full knowledge of their terms and agreed to dismiss The Money Store from this lawsuit in exchange for Flagship's covenant to keep the Lease in full force and effect. Excel refers to a partial transcript of the Rule 50 motions during the jury trial on November 26, 2003:

And I don't know - my tentative ruling is I don't see this as a constructive eviction

1 case.

2 MR. FAIRBROOK: Okay.

3 THE COURT: So I will read those cases and I  
4 will give it some thought, but that's the way  
I see it.

5 MR. FAIRBROOK: Let me underscore one point  
6 for you. I think the critical factor is, and  
7 the evidence is this, that we closed the  
restaurant, the equipment was removed, and it  
remained vacant but for the attempts -

8 THE COURT: I know that, but you are charged  
9 with knowledge of the law and the fact that  
- and there are good reasons, you know, not  
to have sued, but you could have sued the  
lender for putting you in this position and  
for not backing you a hundred percent, and  
you chose to compromise with that lender  
because they have got the gun at your head  
and they are saying, in other words,  
'Mitigate, try to find a new tenant, keep  
paying the rent, don't just use the real  
property remedies here and the contract  
remedies, but primarily the real property,  
which says when you are constructively  
evicted, you have got to go, you have got to  
get out and give back the keys.'

16 ...

17 MR. FAIRBROOK: When they talk about those,  
18 they talk about the benefit that the tenant  
receives by remaining in possession and  
hedging his bets on whether he is going to  
overcome it and none of those, none of those  
things exist here. And that's why I think  
those cases -

21 THE COURT: I know that. And - but what the  
22 law says, and you are not in the strong  
23 bargaining position where you are in default  
on a \$2 million loan, quite frankly, and the  
lender is willing to do anything, except  
24 basically cut you off.

25 So the bottom line is that, unfortunately,  
26 counsel for the lender wasn't willing to  
recognize that your optimum condition was to

1           return the keys and get as far away from that  
2           site as you possibly could.

3           (Excel's Response, Exh. D).

4           Excel further refers to evidence that Flagship retained a  
5           real estate agent from April 2001 through the trial to market the  
6           Premises for sale or sublease and that, in 2001, Flagship had a  
7           specific buyer and conducted negotiations with The Money Store,  
8           Excel, and the potential buyer to sell the Lease and the  
9           Premises. (Excel's Response, Exh. B). Excel asserts in a  
10          footnote:

11           After this proposed sale fell through,  
12          Plaintiffs destroyed the *status quo ante* by  
13          agreeing to a distress sale of the Golden  
14          Corral's restaurant equipment, in which  
15          equipment that Plaintiffs claim 'cost'  
16          \$600,000 was disposed of for \$11,000.00.  
17          Here again, Plaintiffs acted in a manner  
18          wholly inconsistent with rescission.

19          Excel contends that, in October 2003, on the eve of trial,  
20          Flagship sublet the Premises for a Halloween costume store. All  
21          of this conduct, Excel argues, demonstrates that Flagship waived  
22          the right to rescind the Lease by its conduct:

23           Here, Plaintiffs not only continued to treat  
24           the Ground Lease as binding by paying rent  
25           and subletting the premises, but they also  
26           held out the Ground Lease as binding to third  
27           parties, when they attempted to sell it and  
28           the restaurant business.

29          However, as Flagship notes, Excel expressly confirmed during  
30          the trial that Flagship's continued payment of rent was not a  
31          basis for waiver of the right to rescind:

32           MR. CARROLL: Your Honor, I don't believe  
33           there has been any claim made that - because

1           of relevance, that the payment of any of the  
2           lease payments was in any way a defense in  
3           this case.

4           THE COURT: I understand there to be a claim  
5           for the lease payments because there is a  
6           claim for rescission as of the date of notice  
7           of termination of the lease and, therefore,  
8           this is relevant evidence because they are  
9           continuing to pay under protest because they  
10          were required by the lender.

11          MR. CARROLL: We are not contending in this  
12         case that continued payment in any way is a  
13         defense for or impairs their ability to  
14         rescind.

15          THE COURT: It's an element of damage that is  
16         sought to be recovered.

17          MR. CARROLL: But this letter isn't an element  
18         of damages. The check is, your Honor.

19          MR. WASHBURN: There are claims of waiver and  
20         estoppel.

21          THE COURT: So long as waiver and estoppel is  
22         claimed.

23          MR. CARROLL: Not on the defense of any  
24         payments. It has never been in this case.

25          THE COURT: What we will do is this. On that  
26         condition, that there be no argument to the  
27         jury and there be no suggestion that the  
28         continued payment of rent under protest would  
29         be a waiver of [sic] estoppel, which would be  
30         a waiver of any kind of defense. We will  
31         keep the letter out, but we have already got  
32         the witness' testimony about how long they  
33         continued to make these rent payments. [¶]  
34         You may ask your next question.

35          (Excel's Motion, Exh. K, 590:17-591:21).

36          Flagship argues that Excel is now judicially estopped from  
37         asserting that Flagship's continued payment of rent waives  
38         rescission of the Lease. Determining whether judicial estoppel

1 should be invoked is informed by several factors: (1) whether a  
2 party adopts a position clearly inconsistent with its earlier  
3 position; (2) whether the court accepted the party's earlier  
4 position; and (3) whether the party would gain an unfair  
5 advantage or impose an unfair detriment on the opposing party if  
6 not estopped. *New Hampshire v. Maine*, 532 U.S. 742, 750-751  
7 (2001). In addition, Flagship argues that Excel's argument  
8 violates the Ninth Circuit's mandate:

9 The court of appeal's mandate and findings  
10 with respect to the defense of rescission and  
11 judicial estoppel are targeted at Defendants'  
12 attempt to defeat rescission on the basis of  
13 Section 4.5 of the Lease, not on the basis of  
Plaintiffs' conduct. To allow Defendants to  
raise the defense of waiver based on conduct  
at this stage would violate the court of  
appeal's mandate and would amount to  
reconsideration of the jury's verdict.

14 Flagship further argues that the continued payment of rent  
15 under protest on a premises Flagship had vacated and was deriving  
16 no benefit from, does not demonstrate affirmation of the Lease,  
17 citing *DRG/Beverly Hills, supra*, 30 Cal.App.4th at 59: "Waiver is  
18 the intentional relinquishment of a known right after full  
19 knowledge of the facts and depends upon the intention of one  
20 party only." Flagship contends:

21 Defendants offered nothing with respect to  
22 Plaintiffs' intent to negate the evidence of  
23 payment of rent under protest and the intent  
to rescind. The evidence was that Plaintiffs  
24 surrendered possession, but that Plaintiffs'  
surrender was refused by Defendants.  
Moreover, the evidence offered at trial was  
25 that after the close of Plaintiffs' business  
in April 2001, Plaintiffs never operated a  
26 restaurant there or enjoyed use of the

1                   premises. Instead, due to Defendants'  
2 refusal to accept Plaintiffs' surrender as a  
3 means of mitigation, Plaintiffs entered into  
4 an agreement with the bank wherein Plaintiffs  
5 agreed to pay rent ... The evidence further  
6 offered by Plaintiffs demonstrated that with  
7 each rent payment made under protest, a  
8 protest letter was sent, thus indicating an  
9 affirmative intent *not to affirm the lease or  
accept its benefits*, a fact which Defendants  
conceded in order to keep the protest letters  
out of evidence ... In other words, the  
evidence in this case was that Plaintiffs'  
continued payment of rent under the  
forebearance agreements was done not in an  
attempt to do any fact inconsistent with the  
claim of rescission, but simply, as an effort  
to mitigate.

10                  With regard to the rental of the Premises to a Halloween  
11 store, Flagship asserts that Excel is repeating an argument made  
12 unsuccessfully to the jury, that the temporary rental of the  
13 Premises during the litigation and just prior to trial barred  
14 Plaintiffs' constructive eviction claim. Flagship asserts that  
15 Excel's reference to the Rule 50 motion transcript fails to  
16 report that the Court denied Excel's Rule 50 motion on the  
17 constructive eviction claim. (Flagship's Supp. Excerpts of  
18 Record, Exh. 0, 1415-1450). Flagship asserts that Excel did not  
19 argue to the jury that the Halloween store payment was a ground  
20 to deny rescission; the jury found for Flagship on the  
21 constructive eviction claim and that Flagship had mitigated its  
22 damages.

23                  Flagship's entry into the Forebearance Agreements with The  
24 Money Store and its continued payment of rent did not constitute  
25 a waiver of any right to rescind the lease. Flagship continued

1 to make the rental payments under protest. Excel's trial counsel  
2 affirmatively represented to the Court during trial that  
3 Flagship's continued payment of rent did not impair Flagship's  
4 ability to rescind the lease, nor was it used to argue waiver.  
5 The Court made an evidentiary ruling and limited evidence and  
6 argument to the jury based on Excel's representation. To now  
7 allow Excel to argue that Flagship's continued payment of rent  
8 waived any right of rescission would be rewarding bad faith and  
9 is wholly inconsistent with Excel's earlier position, upon which  
10 the Court relied in making rulings and Flagship relied in  
11 limiting its proof. It would give Excel an unfair advantage  
12 which prejudices Flagship at this late stage of the proceedings.  
13 The elements of judicial estoppel are met and Excel is estopped  
14 to claim waiver based on the Money Store loan and Flagship's rent  
15 payments.

16 As to Flagship's attempts to market the premises for  
17 sublease and its sublease in October 2003 do not establish  
18 Flagship's waiver of rescission. Excel never argued to the jury  
19 or during the lengthy post-trial proceedings that these actions  
20 by Flagship waived any right of rescission. Excel's conduct is  
21 unacceptable. Flagship's actions to reduce its losses were under  
22 protest and do not constitute a waiver of the right of  
23 rescission.

24 c. Rescission Barred Because Flagship Failed to  
25 Proffer Written Consent of The Money Store to Extinguish the  
26 Estate Created by the Ground Lease as Required by Section 22.4.

1       For what appears to be the first time, Excel now argues that  
2 rescission is barred because Flagship failed to proffer the  
3 written consent of The Money Store to extinguish the estate  
4 created by the Lease as required by Section 22.4 of the Lease.

5       Section 22.4, captioned "No Merger of Title," provides:

6           There shall be no merger of this Lease or the  
7 estate created by this Lease with any other  
8 estate in the Premises or any portion thereof  
by reason of the fact that the same person,  
firm, corporation or other entity may acquire  
or own or hold, directly or indirectly:

9           (a) this Lease or the estate  
10 created by this Lease or any interest in this  
Lease or in any such estate and

11           (b) any other estate in the  
12 Premises or any part thereof or any interest  
in such estate, and no such merger shall  
occur unless and until all persons,  
corporations, firms and other entities,  
having any interest (including a security  
interest) in (i) this Lease or the Estate  
created by this Lease and (ii) any other  
estate in the Premises or the improvements or  
any portion thereof shall join in a written  
instrument effecting such merger and shall  
duly record the same.

18       Excel contends that an order granting rescission would  
19 effectively extinguish the leasehold estate created by the Ground  
20 Lease and thereby merge Flagship's former leasehold estate into  
21 Excel's fee estate. This merger, Excel argues, is prohibited by  
22 Section 22.4 in the absence of The Money Store's written consent,  
23 which Flagship did not proffer. Excel cites *Swanston v. Clark*,  
24 153 Cal. 300, 304 (1908) as authority.

25       *Swanston*, a more than 100 year old case, first surfacing  
26 eight years after this action commenced, involved an action to

1 enforce specific performance of a written contract to sell real  
2 estate. The complaint alleged that the contract consisted of a  
3 lease for five years and an option to the lessees to purchase the  
4 property at any time during the term of the lease for a fixed  
5 price per acre; that plaintiffs, the lessees, elected to buy the  
6 land pursuant to the option, made due tender of the purchase  
7 price and demanded execution of the deed, which defendant  
8 refused; that two clauses to which the parties had agreed, to the  
9 effect that the plaintiffs were to allow improvements made by  
10 them during their possession to remain on the premises, in case  
11 they failed to exercise the option to purchase, and that  
12 plaintiffs should pay the rent for the five years, if they did  
13 not sooner exercise the option to purchase, were, by mutual  
14 mistake, omitted from the contract, and that by like mistake a  
15 clause was inserted giving plaintiffs the right to remove such  
16 improvements if they did not purchase. The defendant, in her  
17 answer, alleged that the contract had been rescinded by her  
18 before the plaintiffs' tender. The Supreme Court affirmed,  
19 sustaining a demurrer to this part of the answer:

20 It did not aver an offer to repay the  
21 plaintiffs the money expended by them in  
22 improvements on the land, but only to repay  
23 the moneys 'paid her by them' and 'to restore  
24 everything received by her under the  
25 agreement.' The complaint alleges the making  
26 of valuable improvements by the plaintiffs on  
the faith of the option to purchase. This  
special answer did not deny the making of  
these improvements and it cannot be said that  
the improvements had been 'received' by the  
defendant. Hence, the offer to restore, as  
alleged in the answer, did not include an

offer to compensate the plaintiffs for the moneys expended by them in improving the property and was insufficient to accomplish a rescission. Again, a party to a contract cannot rescind at his pleasure, but only for some one or more of the causes enumerated in section 1689 of the Civil Code. One seeking to rescind a contract, or to enforce a rescission when he claims he has effected in the manner provided in section 1691 of the Civil Code, must allege facts showing that he had good right to rescind, and for what cause a rescission had taken place, or that a rescission had been made by consent ... The same rule controls where a rescission is averred as a defense ... The special defense does not aver any facts in regard to defendant's right to rescind and does not show a rescission by consent. It is therefore insufficient.

The court did not err in adjudging that the defendant should convey the land free from all liens and encumbrances. The contract provided that she should convey it free from all liens and encumbrances, 'except such as may be created by the terms of this instrument as a lease of said premises.' The conveyance of the property to the plaintiffs in fee would effect a complete merger of the two estates, and the lease would not thereafter be an encumbrance. The execution of the deed by the defendant would be a complete performance so far as the lease was concerned. The contract, as reformed, did not contemplate or provide that she should retain any right or interest under the lease after she had conveyed in pursuance of the option, even if it did not have that effect before reformation. The lease, therefore, did not constitute an encumbrance within the scope of the covenants in a grant deed. We cannot, upon these appeals, take notice of any liens for reclamation district taxes that may have accrued after the trial. The defendant, it may be observed, could have escaped that liability at any time by performing the liability accrued. The statement in the record relating to the motion made by defendant to amend the judgment so as to except such liens, and the

1                   order denying the same, show that the  
2                   judgment was entered before the motion and  
3                   order were made. It was therefore an order  
4                   made after final judgment and it cannot be  
5                   reviewed on appeal from the judgment itself.  
6                   The defendant did not appeal from the order.  
7                   As to the liens for ordinary taxes, which may  
8                   be presumed to have accrued between the time  
9                   of plaintiffs' tender, in January, 1903, and  
10                  the date of the entry of the judgment, in  
11                  January, 1905, it is sufficient to say that  
12                  the defendant, having refused to accept the  
13                  money and make the deed as the judgment  
14                  declares she should have done, is in no  
15                  position to complain of the consequence of  
16                  her own breach of contract.

17                  Flagship replies that Section 22.4 is not an anti-rescission  
18                  clause:

19                  Rather, its purpose is simply to prevent the  
20                  extinguishment of the Lease by operation of  
21                  the doctrine of equitable conversion in the  
22                  event the ground upon which the restaurant  
23                  was acquired by Flagship, the lessee [sic].  
24                  This clause simply has no application to  
25                  Plaintiffs' claim of rescission. Nor does  
26                  this provision make a third party's consent  
27                  necessary for the Plaintiffs to elect any  
28                  particular remedy. It simply prevents a  
29                  merger of the leasehold estate with the fee  
30                  estate, in order to protect secured lenders  
31                  such as The Money Store. In fact, this  
32                  provision is simply a confirmation of the  
33                  equitable nature of the doctrine of merger,  
34                  and the principle 'that the doctrine [will]  
35                  not be applied to extinguish a leasehold  
36                  estate when the lessee acquire[s] the fee,  
37                  when the application of the doctrine would  
38                  [prejudice the rights of an innocent third  
39                  party.]'

40                  In so asserting, Flagship cites *6424 Corporation v.*  
41                  *Commercial Exchange Property, Ltd.*, 171 Cal.App.3d 1221 (1985).

42                  *6424 Corporation* involved real property subject to a 99-year  
43                  ground lease which began in 1912. Holland Park Investors

1 (Holland) became the owner of the leasehold interest on December  
2 17, 1980. The leasehold at that time was subject to purchase  
3 money encumbrances consisting of a \$400,000 first trust deed in  
4 favor of Commercial Exchange (CEL), an \$840,000 all-inclusive  
5 second trust deed in favor of La Mesa Enterprises (La Mesa), and  
6 a \$2.2 million all-inclusive third trust deed in favor of  
7 Commercial Exchange Property (CEP). Holland immediately sold its  
8 leasehold interest to the Kures. Two days later, the Kures  
9 purchased the fee interest in the property, thereby becoming  
10 concurrent owners of the fee and the leasehold. Two years later,  
11 the Kures conveyed their interests in the property by grant deed  
12 to IFR Realty, which the next day conveyed the property to Wendt.  
13 In that transaction, Wendt executed and delivered a trust deed in  
14 favor of IFR which encumbered the fee. A year later, IFR  
15 assigned Wendt's trust deed to 6424 Corporation. Thereafter,  
16 6424 Corporation brought an action for declaratory relief and  
17 cancellation of instruments, asserting that the leasehold was  
18 merged with the fee when the Kures acquired concurrent ownership  
19 of both estates, with the result that the liens associated with  
20 the trust deeds of CEL, La Mesa and CEP were extinguished. The  
21 trial court granted summary judgment for CEL, La Mesa and CEP,  
22 declaring that the leasehold and the fee did not merge so as to  
23 render their trust deeds invalid. The Court of Appeals affirmed:

24 While various arguments for reversal and in  
25 support of the trial court's determination  
26 are proffered by the parties, we are of the  
view the matter is disposed of by a principle  
sufficiently fundamental as to require little

1 discussion, namely that: 'The doctrine of  
2 merger is to be applied in a manner  
3 calculated to prevent injustice, injury and  
4 prejudice to the rights of innocent third  
5 persons [such that] it has been held that the  
6 doctrine [will] not be applied to extinguish  
7 a leasehold estate when the lessee acquire[s]  
8 the fee, when the application of the doctrine  
9 would [prejudice] the rights of an innocent  
10 third party.' ....  
11

12 In contravention of this well-founded and  
13 manifestly equitable proposition, what is  
14 sought to be established by appellant is no  
more nor less than that, based solely upon  
the circumstance of the fee and the leasehold  
estates having been placed in the ownership  
of the Kures, the otherwise legitimate  
interests of respondents, acknowledged and  
accepted as valid by the Kures ..., should be  
found to have disappeared, through  
application of a rule which in all events  
'arose out of the fondness of the law for  
convenience and symmetry, [but which] was  
never designed to defeat the rights of a  
third party, which had intervened before the  
merger took effect.' ....

15 171 Cal.App.3d at 1223-1224.

16 Excel argues that *6424 Corporation* is distinguishable:

17 There, the lease did not contain an anti-  
18 merger clause, whereas here, § 22.4  
19 specifically requires the signature of all  
20 interested parties as a precondition to  
extinguish the lease. Furthermore, it was  
21 the tenant in *6424 Corp.* that had acquired  
22 the fee estate and, thereafter, wrongfully  
23 attempted to escape its liabilities by  
extinguishing the interests of the leasehold  
24 mortgagees via merger. In contrast, here,  
25 the effect of the tenant rescinding would be  
to merge the lease estate into the landlord's  
fee estate. The litigation issues in *6424*  
*Corp.* were the result of the absence in that  
lease of a provision such as § 22.4. *6424*  
*Corp.* is actually a case study to remind  
practitioners to include clauses such as §  
22.4, particularly in long-term ground  
leases.  
26

1       Flagship argues that The Money Store consented to the  
2 prosecution of the action, including the claim for rescission  
3 when it entered into the Forebearance Agreements with Flagship.  
4 Flagship refers to Paragraphs 6-7 of the October 2001  
5 Forebearance Agreement :

6       D. The parties have reached an agreement to  
7 forebear on the existing collection actions  
8 and lawsuit. In consideration of the mutual  
9 promises, covenants, conditions and terms set  
10 forth herein, and in consideration of the  
accuracy of the Recitals, which are hereby  
confirmed and incorporated into this  
agreement by this reference, the undersigned  
parties hereby agree as follows:

11       ...

12       6. TMSIC hereby agrees to release  
13 its interest in the Modesto Property at 1800  
14 Prescott Road in Modesto, California for the  
15 sum of \$900,000 provided that sum is the  
16 proceeds from the result of the sale to Mr.  
17 Valdez and Mr. Vaca or such other tenant as  
18 the landlord may approve provided that the  
19 minimum release payment from such other  
20 tenant as the landlord may approve will be  
\$900,000 or the net proceeds available from  
the sale, whichever is greater. It is  
understood that this payment amount shall be  
applied to past due arreages on the Modesto  
loan and then to the principal on the Modesto  
loan. At no time should the payment under  
this paragraph exceed the balance due under  
the loan.

21       7. Flagship and Reiche agree to  
22 execute an appropriate assignment to Money  
23 Store and TMSIC the [sic] net proceeds of the  
24 litigation of Reiche and Flagship in Case No.  
25 290308, in Stanislaus County [removed on  
February 21, 2001 and assigned Case No. CV-F-  
02-5200]. The proceeds will be applied to  
the past-due arrearages on the Modesto Loan,  
if any, and then to a reduction of the  
principal balance. Flagship will be  
reimbursed for all costs, attorney fees and

1 expert witness fees and other expenses  
2 incurred in the litigation, including  
3 Flagship's payment of rent to the landlord  
4 since the closure of Flagship's restaurant on  
5 April 1, 2001. The reimbursement will first  
6 come from the proceeds of the litigation.  
7 The first \$500,000.00 of the net proceeds  
8 would go to TMSIC. Any net proceeds over  
\$500,000.00 from the litigation will be  
equally divided between TMSIC and Flagship.  
TMSIC will share in the net proceeds only to  
the extent required to satisfy past-due  
arrearages on the Modesto Loan and pay the  
principal balance on the Modesto Loan in  
full.

9 (Excel's Response, Exh. B). Flagship asserts that the interests  
10 of The Money Store were fully protected in the Forebearance  
11 Agreement "and no intent is evinced by that agreement that The  
12 Money Store, originally a party to the lawsuit and well aware of  
13 Flagship's claims for rescission, had any objection to the remedy  
14 of rescission."

15 Excel replies that Flagship's reliance on Paragraphs 6-7 of  
16 the October 2001 Forebearance Agreement is misplaced. Referring  
17 to Paragraph 6, Excel contends: "Obviously, Plaintiffs never  
18 adduced evidence of a sale to Mr. Valdez and Mr. Vaca or anyone  
19 else, because such event did not occur." Excel contends:

20 Nothing in the Forebearance Agreement  
21 provides the written consent required by §  
22.4. On the contrary, the Forebearance  
Agreement requires Plaintiffs to pay rent and  
otherwise maintain the Ground Lease in good  
standing to protect TMS's security interest.  
(*Id.* at ¶¶ 4,7).

24 Excel asserts that the October 2002 Forebearance Agreement  
25 deleted paragraph 6 and was silent with respect to The Money  
26 Store's security interest.

1       Excel's view of the terms of the October 2002 Forebearance  
2 Agreement are misplaced. While the references to the proceeds of  
3 the sale to Valdez and Vaca were deleted, it does not appear that  
4 the October 2002 Forebearance Agreement "was silent with respect  
5 to The Money Store's security interest." Section F of the  
6 October 2002 Forebearance Agreement provides:

7       The parties have reached an agreement to  
8 forebear on the existing collection actions.  
9 In consideration of the mutual promises,  
10 covenants, conditions and terms set forth  
11 herein, and in consideration of the accuracy  
12 of the Recitals, which are hereby confirmed  
13 and incorporated into this agreement by this  
14 reference, the undersigned parties hereby  
15 agree as follows:

16       1. Money Store and TMSIC shall  
17 forebear from filing their Notice of Sale on  
18 the Stockton Loan and the Modesto Loan.

19       ...

20       4. Flagship and Reiche shall  
21 continue to make monthly lease payments on  
22 the Modesto Property to Excel Realty Partners  
23 ....

24       5. Net proceeds of any litigation  
25 between Reiche and Flagship in the United  
26 States District Court, Eastern District case  
... will be applied to past due arrearages on  
the Modesto Loan, if any, and then to a  
reduction of the principal balance. Flagship  
will be reimbursed for all costs, attorney  
fees and expert witness fees and other  
expenses incurred in the litigation,  
including Flagship's payment of rent to the  
Landlord since the closure of Flagship's  
restaurant on April 1, 2001. The  
reimbursement will first come from proceeds  
of the litigation. The first \$500,000.00 of  
the net proceeds will go to TMSIC. Any net  
proceeds over \$500,000.00 from the litigation  
will be equally divided between TMSIC and  
Flagship. TMSIC will share in the net

1           proceeds only to the extent required to  
2           satisfy past due arrearages on the Modesto  
3           Loan and pay the principal balance on the  
4           Modesto Loan in full.

5           6. The forbearance of publishing  
6           the Notice of Sale shall continue until the  
7           earlier of the failure of Reiche and Flagship  
8           to honor each and every term and condition  
9           obtained herein, the issuance of a final  
10          judgment in Case No. CIV-F-02-5200 REC DLB,  
11          in the United States District Court, Eastern  
12          District, or twelve (12) months from the date  
13          of execution of this Agreement.

14         (Excel Response, Exh. C.).

15         Flagship further asserts: "[A]s noted on the record, The  
16         Money Store received payment, and accordingly no longer has any  
17         interest in the property." In so asserting, Flagship refers to  
18         the transcript of a status conference on February 15, 2006:

19         THE COURT: All right. And as I then would  
20         understand it, all of this activity that is  
21         the subject of concern happened after the  
22         trial and after Mr. Reiche's accident.

23         MR. FAIRBROOK: Yes ... A year and a half  
24         after the trial, we did enter into  
25         negotiations and we retired that obligation.  
26         And, as a result, the only significance to  
1           this case is that the Court had indicated in  
2           its prior ruling that we would receive as  
3           compensation interest on that loan, not - the  
4           principal was never alleged to have been an  
5           item of damage, but simply the financing  
6           charges. [¶] And in the submission that we  
7           submitted to your Honor, we stopped the  
8           accrual of that interest at the same time as  
9           that loan was retired, and that's the only  
10          significance that I can see on this.

11         (Flagship's Supp. ER, Exh. Q, 4:23-5:13). Flagship also submits  
12         Exhibit S in its Supplemental Excerpts of Record, a Substitution  
13         of Trustee and Reconveyance of Deed of Trust dated September 20,

1 2005, wherein The Money Store reconveyed any interest it is the  
2 lease as part of the deed of trust to Flagship.

3 Excel moves to strike Exhibit S to Flagship's request for  
4 judicial notice filed in support of its reply brief and pages  
5 15:20-16:19 of Flagship's reply brief. Alternatively, Excel  
6 moves for leave to file a sur-reply brief.

7 In moving to strike, Excel relies on the Supplemental  
8 Scheduling Conference Order filed on August 14, 2009 (Doc. 499),  
9 states: "Plaintiff shall not raise any new matter in the reply  
10 memorandum of law."

11 It is Excel, not Flagship, that raised this issue in its  
12 opposition brief. The Supplemental Scheduling Order was not  
13 intended to preclude Flagship from responding to arguments made  
14 by Excel in its opposition to Flagship's motion.

15 Excel also bases its motion to strike on the ground that  
16 Flagship's exhibit and argument violate that "Memorandum Decision  
17 Re Rescission Damages and Availability of Prejudgment Interest"  
18 filed on November 14, 2006, (November 14, 2006 Memorandum  
19 Decision; Doc. 387), which Excel asserts barred evidence of  
20 Flagship's post-trial dealings with The Money Store. The portion  
21 of the November 14, 2006 Memorandum Decision discussing accrued  
22 interest on The Money Store Loan through trial, provides:

23 Most critically, what Wallace did not do was  
24 to calculate (or otherwise consider) the  
effect of the foreclosure agreement on the  
calculation of interest accruing after  
25 October 2001. Nor did he give credit for the  
\$900,000 lump sum payment or calculate  
26 interest based on the reduced unpaid

1 principal balance resulting from the lump sum  
2 payment. It was incumbent on Plaintiffs to  
3 make these calculations. They have not done  
4 so. They have failed to prove the amount of  
any accrued unpaid interest on the Money  
Store Loan and the effect of the forbearance  
agreement on the accrual of interest.  
*Plaintiffs did not present this information*  
*at trial and refused to provide such evidence*  
*post trial. They are bound by their choice.*  
*Plaintiffs shall not recover any other*  
*accrued interest.*

7 (Doc. 387; 20:9-21, emphasis added]. Excel argues that Flagship  
8 is bound by this ruling and by their choice that evidence of  
9 Flagship's post-trial dealings with The Money Store will not be  
10 admitted. Excel contends that Flagship now attempts a "back door  
11 maneuver" to put into the record evidence that the November 14,  
12 2006 Memorandum Decision bars, Exhibit S. Excel contends that  
13 the stated purpose for proffering Exhibit S is to show that The  
14 Money Store received payment and, accordingly no longer has any  
15 interest in the property:

16 Plaintiffs had the burden to prove at trial  
17 that they were entitled to rescind the Ground  
18 Lease, but they failed to meet it. It was  
not Excel's burden to prove that rescission  
was unavailable. Plaintiffs failed to adduce  
evidence of TMS's consent to a merger of the  
Ground Lease estate with the fee, which would  
be the direct result of the rescission  
Plaintiffs sought. Evidence of TMS's consent  
was essential for Plaintiffs to comply with §  
22.4, and Plaintiffs are foreclosed from  
proffering it now.

23 As the ruling provides, Flagship was precluded from offering  
24 evidence about postjudgment interest. To the extent that Excel  
25 moves for leave to file a sur-reply brief addressing the impact  
26 of Exhibit S, the motion is moot. Excel's arguments in

1 opposition to Flagship's discussion of Exhibit S have been fully  
2 considered.

3 Flagship was not required to obtain Excel's written consent  
4 to the Money Store loan. There is no merger. Excel's arguments  
5 fail.

6 CONCLUSION

7 For all the reasons stated, the lease, in its entirety,  
8 allows for rescission and California law would give effect to  
9 rescission of the lease under the totality circumstances of this  
10 action.

11 IT IS SO ORDERED.

12 Dated: December 20, 2010

13 /s/ Oliver W. Wanger  
14 UNITED STATES DISTRICT JUDGE

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